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PROPOSED EXTENSION OF THE INTERNET TAX MORATORIUM

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

JULY 16, 2003

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

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PROPOSED EXTENSION OF THE INTERNET TAX MORATORIUM

WEDNESDAY, JULY 16, 2003

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 9:34 a.m. in room SR–253, Russell Senate Office Building, Hon. John McCain, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. Good morning. I thank all of you for joining us today for this important hearing on the Internet tax moratorium, although I must say to my friends, Senator Wyden and Senator Burns and Senator Allen, when he shows up, this reminds me of the old line from Yogi Berra, "It's déjà vu all over again." Every year, we go through this complicated process and end up with what is generally a temporary extension. And, sooner or later, we need to address this issue in a comprehensive fashion. And, although I always am willing to put all the blame on ourselves for not acting appropriately, this is an issue which is constantly changing due to evolving technologies and greater use of the Internet, and not one that is static.

As my colleagues know, the moratorium was first passed in 1998. It was extended for 2 years in 2001, after many weeks of difficult debate. It's now set to expire November 1 of this year. And it's my hope, continuing hope—hope springs eternal—that we can reach a consensus to enable the enactment of another extension. Among other things, continuing the moratorium would help ensure that Internet access continues to grow by keeping the Internet free from overly burdensome taxation.

In past years, the debate over the moratorium has been mixed together with several states' efforts to broaden their authority to collect taxes, sales taxes, from remote sellers. In fact, many people, even today, seem to think that the Internet tax moratorium, which addresses only Internet access taxes, as well as discriminatory and multiple taxes on e-commerce, is a ban on sales taxes on e-commerce transactions. It is not.

This year, I believe that we can and should keep the Internet tax moratorium distinct from the simplified sales tax debate. I do, however, expect to address, in a separate hearing later this year, the sales tax issue, and the Streamlined Sales Tax Project, SSTP, in particular. The sales tax question is a matter of significant impor-

tance, and I look forward to seeing if there is evidence that the states participating in the SSTP have advanced toward true sales tax simplification.

For now, though, the primary focus of our discussion and debate should be on the Internet tax moratorium, which, itself, will present some complex issues, especially if we are to move forward with legislation that extends the moratorium permanently. Both Senators Allen and Wyden have sponsored such legislation, and I thank them for their continuing efforts to advance the extension of the moratorium.

I hope we can move to extend the moratorium before the November deadline, which is fast approaching. I also hope that this process will not stall as the various stakeholders attempt to reach consensus language on such matters as the proper definition of "Internet access" in the moratorium legislation.

I look forward to an informative hearing this morning and thank the witnesses for appearing today.

Just one additional comment. As we see the budgetary woes of the states, we also see them understandably looking for sources of revenue. So we will see more pressure from governors all over America this year than we have in the previous times when we debated this, when there was surplus, when most states were running surpluses. That's a political reality that I think we have to understand, which probably highlights even more the importance of this issue.

Having said that, I'd like to ask my colleagues if they have additional comments, beginning with Senator Wyden——

Senator WYDEN. Thank you.

The CHAIRMAN.—who has worked assiduously with Senator Allen on this issue, and I am grateful for theirs and Senator Burns' participation in this very difficult and, as I mentioned in my opening statement, sometimes misunderstood issue.

Senator Wyden?

STATEMENT OF HON. RON WYDEN,
U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you, Mr. Chairman. And you are so right about the nature of this debate. This is like the song, "We Have Passed This Way Before," and you have been very gracious about your time and the Committee's time in an effort to try to get at this.

When I started pursuing this, five years ago, with Congressman Cox, and we wrote the original law, and have teamed with Senator Allen and Senator Burns, what we sought to do was establish essentially just one principle, and that is that there should be technological neutrality, that you should treat the online world the same way you treat the offline world. And what we have long been concerned about was discriminatory taxes on electronic commerce. The example we cited, for example, was if you bought the newspaper the traditional way, the snail mail way, you wouldn't pay a tax; if you bought the online version, you paid a tax. That was what the Internet Tax Freedom Bill was all about. It barred those discriminatory taxes on electronic commerce.

We sat in this room more than five years ago, people were at that table, and they said, Western civilization is going to end if we pass this bill, that you're not going to have the revenue that we need, and various kind of services, from law enforcement to property taxes and the like, would all be decimated. That has not been the case.

Mr. Chairman, you're correct on this point on the budget. The five-year history of this legislation is, when we started the budget was in a deficit. Then we had very large surpluses. Now, once again, we have deficits. So the budget has been all over the map on it.

But the fact remains that, to this day, 5 years after we have been pursuing this subject, not a single local jurisdiction has come forward and demonstrated that they have been hurt by their inability to impose discriminatory or multiple taxes on the Internet.

So that is a bit of the history. I also want to say, Mr. Chairman, that I share your view that this is a very distinct effort from the whole question of the state Streamlined Sales Tax Project. Our legislation, what Senator Allen and I have been pursuing, what Congressman Cox has been pursuing, in no way slows down the effort of the states to collect taxes that are owed. What we do here doesn't even provide a speed bump, certainly not a block, to the effort by the states to streamline sales tax collections.

Last point is, we will clearly have some work to do on defining, this time around, "Internet access," because clearly with all the technologies that have become available since we first began to tackle this issue, there have been some changes in this area, but upwards of 97 million Americans have Internet access. They're already paying taxes on cable and phone lines that they use for their hookup. And certainly they want us to be sensitive, to make sure that they are not paying double the taxation for their Internet access. But we will have some complicated questions to define "Internet access," given the changes since our original law.

Again, I thank you for all the time that you've given me. I can't even estimate how many hours we've spent in your office working on these arcane kind of matters, and we thank you for it.

The CHAIRMAN. Thank you very much.

Senator Burns?

STATEMENT OF HON. CONRAD BURNS,
U.S. SENATOR FROM MONTANA

Senator BURNS. Thank you, Mr. Chairman, for holding this hearing today and kind of getting a jumpstart, because the deadline's coming up. And I want to thank you for holding this hearing.

There's a lot of us on this Committee that's had an interest in this topic for a long, long time. In my tenure in the Senate, I've made it a priority to make telecommunications, the Internet services, affordable, and a reality to states like my own, which are remote states and who rely on electronic commerce probably a little more heavily than those folks who live in more urbanized areas. Fortunately, the technology has become less complicated than the laws regarding it may be.

The Internet has emerged as an important vehicle in our Nation's economy. And even though we've had a downturn in the

economy, we've still shown some growth in the Internet business—business-to-business, business-to-customer commerce—which is still a relatively small part of—when you compare it to the size of our economy. So we've got to do our part to ensure that our actions continue to provide support for this industry that promises new business process and paradigms to the marketplace and, I think, will reduce costs and costs to the customer services and also cost in goods.

And I support what Senator Wyden and Senator Allen have done. They've worked very, very hard on this particular matter. Ever since the Senator from Virginia has come to the Senate, he's shown a lot of leadership in this area. We want to make sure that customers pay less for Internet services, and also that they pay less in taxes. The work we did extending the moratorium in 1998, and, of course, again in 2001, was commendable and hopefully set the foundation for permanent repealing.

I don't think this is an issue that we need to revisit every few years. I agree with the Chairman on that wholeheartedly. In my way of thinking, taxing Internet access is a shortsighted strategy that would tend to exclude our citizens from not only participating fully in the digital economy, but, indeed, from engaging in a digital democracy at the community, state, and national level. And so, as legislators, we should know the worst thing we can do is to create uncertainty in the marketplace in our tax structure. So small businesses rely on the stability, and that's what we should provide.

Now, we know there are other things that are pending out there that kind of slows the development of the digital economy, and we aim to address those issues this year. And so I think there are many more benefits to a permanent moratorium on this tax. It has been advocated by a lot of the states. But I think keeping the tax off there and letting it grow has been one of the greatest things that we've ever done.

So, Mr. Chairman, I would submit the rest of my statement, but thank you for the hearing today. And I want to thank—I want to commend Senator Wyden and Senator Allen for the work they've done on this.

The CHAIRMAN. Well, I thank you, Senator Burns, for the work that you have done.

Senator Lautenberg?

STATEMENT OF HON. FRANK R. LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. Thanks, Mr. Chairman, for holding this very timely hearing.

And I want to just address my comments to the situation the states find themselves in. They're facing the biggest fiscal crisis almost since the Great Depression. According to the Center for Budget and Policy Priorities, states are facing budget deficits of approximately $100 billion that have to be closed over the next several months, on top of the $50 billion gap they closed when they enacted their fiscal 2003 budgets.

Now, sales and use taxes generate $150 billion each year and account for one third of the average state's total revenues. As more and more business-to-consumer and business-to-business commerce

shifts to the Internet, state and local governments will see their tax bases shrink.

According to Jupiter Communications, 94 percent of all e-commerce sales over the next several years will be substitutes for traditional commerce. Only 6 percent of e-commerce sales will be brand new. In the competition that exists for local merchants, people who put up the brick and the mortar and pay the real estate taxes and employ people, could be disadvantaged if we continue to permit sales to be executed without paying a fair share of the state and the community costs for operations.

I'm not an advocate for more taxes, believe me, but I think there has to be a balance in the way we do our business, and the respect and the regard that we have for the local merchants. Even though e-commerce is still just a fraction of the total commerce, the trend is clear, and it spells questions for the ability of state and local governments to provide the services their constituents demand and need. The GAO estimates that states will lose as much as $20 billion in tax revenue because of the Internet, in 2003.

Now, I come out of the computer service business. I helped start a company, a longer time ago than a couple of you at the table—I don't want to try and identify which ones—but we were at the leading edge of information technology. The company is ADP. And no one has a greater appreciation of the benefits that Internet technology and e-commerce can deliver to our society. But I also appreciate the benefits that government alone delivers to its citizen. To deliver these benefits, the government's got to have the revenue. So it's imperative that we examine the impact that the Internet and e-commerce are having on the ability to have the revenue available.

And this should be, Mr. Chairman, an informative hearing. And I can't pass the moment without saying that you've had lots of informative hearings, and the e-speed with which you get these done is quite notable, and I commend you for it.

Thanks, Mr. Chairman.

The CHAIRMAN. I thank you, Senator Lautenberg.

Senator Allen? Welcome.

STATEMENT OF HON. GEORGE ALLEN, U.S. SENATOR FROM VIRGINIA

Senator ALLEN. Thank you, Mr. Chairman. I want to thank you, Mr. Chairman, Senator McCain, as a Senator and as the Chairman, for calling this hearing today, and thank all our witnesses. But, Mr. Chairman, under your leadership and working with like-minded Senators, Senator Wyden and Senator Burns and others, I've made one of my top priorities the extension—in fact, I'd love to see a permanent extension of taxes on the Internet. And I do think—a permanent moratorium on access—yes, I know, thank you. Thank you, Trent. I've made a priority a permanent extension of the moratorium on access taxes on the Internet, as well as a ban on any new taxes that discriminate against Internet transactions.

The Federal Government—I know folks talk about the local and state government and so forth, but the Federal Government clearly has jurisdiction in this matter, because the Internet tax policies, regulatory policies, that relate to the Internet are clearly—it's

clearly an interstate and, in fact, international mode of commerce and information.

I, personally, cannot ever envision a time where it would be appropriate that we would want to allow discriminatory taxes or access taxes on the Internet. Putting access taxes on the Internet will only make it less available to those people of lower income, to folks in rural areas, about 50 percent of the population of this country who is currently not logged onto the Internet. In addition, for the approximately 50 percent of individuals, families, and small businesses that are logged onto the Internet, it's going to increase their cost of operations. You understand very clearly that any dollar you add to the cost of Internet access will just make it less likely, less opportunity, for those of lower income to have access to the Internet for information, for exploration, for individual opportunity in education.

As you stated, Mr. Chairman and Senator Wyden, too often the moratorium on Internet taxation is linked—and, actually, in my view, held hostage—to the issues surrounding the sales-and-use tax simplification, or the compelling of remote businesses or enterprises that have no nexus or physical presence in a state to collect and remit taxes to approximately 7600 different local and state taxing jurisdictions.

I'd like to make abundantly clear, on this point, that the Internet Tax Nondiscrimination Act, which was my bill, S. 150, is completely unrelated and does not prohibit online sales taxes. The bill simply prevents taxation on Internet access and prohibits multiple and discriminatory taxes.

This debate is not about sales tax collection. It's a debate about the individuals or the consumers' ability to access the Internet and to prohibit discriminatory taxation of Internet transactions. The issue of remote sales collection and simplification is extremely complicated, it's a cumbersome issue, and it deserves this Committee's attention, but not at the expense of a person's ability to access the Internet.

Mr. Chairman, as you know, two years ago Congress let the access-tax moratorium lapse for about 14 days. Considering the timing of this hearing, and with the current moratorium set to expire again in November, I'm hopeful and would appreciate, Mr. Chairman, if this Committee could move as expeditiously as possible, try to markup my legislation before we adjourn for the August recess.

It's my understanding that today the House is already holding hearings on this topic, and they expect to move companion legislation, similar to Senator Wyden's and mine, through the Judiciary Committee. I think it's important that the House and Senate move together and send a clear message to the American people that Congress is working to preserve their freedom to a tax-free Internet.

And, finally, Mr. Chairman, I'm one who stands on the side of freedom of the Internet, trusting free people and enterprise, not on the side of making this advancement in technology easier, or a new method of communication to be taxed by avaricious local commissars. In my view, Congress should be promoting and seeking to remove barriers that prevent people from enjoying this inno-

vative technology and keep the Internet free from discriminatory or access taxes.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Allen. I had not quite thought of it in quite such graphic terms, but your argument is very well presented and very well made, and your many year involvement in this issue, and Senator Wyden and Senator Burns, has been very much appreciated.

I take your recommendations seriously, and I'll see what we can do to see if we can't mark this up before we go into recess, because then it would have to have some kind of—also require some time for floor consideration, I am sure.

Senator Lott?

STATEMENT OF HON. TRENT LOTT,
U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. No questions, Mr. Chairman. I had hoped to hear some of the statements from the witnesses.

Thank you for having the hearing.

The CHAIRMAN. Thank you, sir.

Our first panel, in our panel of witnesses, is Mr. Joseph Ripp, who is the Vice Chairman of America Online; Mr. Paul Misener, who's the Vice President for Global Public Policy, Amazon.com; Mr. Mark Beshears, who is the Assistant Vice President of State and Local Tax of Sprint Corporation; and Mr. Billy Hamilton, the Deputy Comptroller, the Texas comptroller, of Public Accountants.

Welcome, and we'll begin with you, Mr. Ripp.

STATEMENT OF JOSEPH A. RIPP, VICE CHAIRMAN,
AMERICA ONLINE, INC.

Mr. RIPP. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Commerce Committee, thank you for inviting America Online to provide its perspective on the Internet Tax Nondiscrimination Act. Specifically, Mr. Chairman, I'd like to thank you for holding this important hearing, and also thank you for your ongoing leadership on this critical issue facing the online medium and online consumers.

I would also like to salute, on behalf of our millions of members, the authors of the pending legislation on making permanent the moratorium on Internet taxation, our home state senator, Senator George Allen, and Senator Ron Wyden for all of your efforts and hard work on this issue. AOL strongly supports enactment of this legislation to make permanent the moratorium on state taxation on Internet access.

Since 1985, AOL has been the leading pioneer in providing access to the content and other services offered by the Internet. AOL members now number over 25 million in the United States, and our experience in this field has taught us several things about our industry and our members.

First, Internet access technologies are still changing continuously. Second, broadband rollout remains critical to the expansion of Internet access. And, third, about half of the American people currently have access to the Internet access services. That's an ex-

cellent record in one decade, but it means we are only one-half way to our goal.

We know something about those Americans who do not have Internet access. They tend to be disproportionately poor, less educated, elderly, minorities, or live in rural communities. We believe several factors will play a critical role in reaching this remaining 50 percent of Americans—technological enhancements, keeping online services and Internet access affordable for average consumers, and constant upgrading of basic services to make each person's online experience more useful or entertaining.

To that end, AOL has led the way in reaching out to underserved communities. One of our best examples is AOL at School, an innovative, groundbreaking service that we provide free to over 10,000 schools nationwide and to the Internet population who are not our subscribers. This Internet service for school kids, in grades K through 12, as well as other online educational tools offered through AOL via tutoring, homework assistance, self-testing, research tools, and mentoring, literally making the world of knowledge a keystroke away for America's next generation. National tax policy will directly impact our industry's ability to achieve these objectives.

The mid-1990s witnessed a major increase in individual home use of the Internet. This expansion was noted by state and local tax administrators. By 1997, several state and local governments had begun to enact Internet taxes on Internet access. Tacoma, Washington, Chandler, Arizona, the State of Connecticut, and handful of other states imposed taxes on Internet access. These initiatives involved widely varying tax theories, tax rates, and compliance regulations. Because some state tax administrators mistakenly equated Internet access with telecommunications, access providers faced the specter of potentially filing over 55,000 different tax returns each year.

Many state and local rules impose taxes based on a customer location, a fact that ISPs often cannot determine with consumers using dial-up access. State and local taxes also threaten price increases for consumers. Taxes on the full amount of the basic monthly dial-up subscription service for typical AOL members would increase their cost by two to three dollars per month and as much as five dollars to ten dollars per month for high-end broadband subscribers. Additionally, the cost of tax compliance would have to be figured into each new technological and service enhancement, and, in some cases, would alter our decisions.

However, in 1998, Congress passed the Internet Tax Freedom Act to halt the proliferation of state and local taxes on Internet access. Not coincidentally, in the five years the moratorium has been in place, the entire access industry has made great strides toward improving online services, expanding service to more places, and increasing the number of people logged onto the Internet. We have also been successful at extending digital opportunities to more Americans of poorer means, less education, and less affluence. Indeed, I can say, unequivocally, that we would not have as many Americans logged on today, through a diverse array of providers, had the Congress never enacted the Internet Tax Freedom Act.

That brings us to today's hearing and this Committee's consideration of the Internet Tax Nondiscrimination Act to make the moratorium of the last 5 years permanent and national in scope. AOL sees several advantages in passage of this law. It will promote digital opportunities for the 50 percent of Americans who do not currently have Internet access by preventing tax base price increases. It will protect consumers and providers from the additional costs that would be necessary to comply with a multi-jurisdictional tax system. Enactment will promote competition in the industry. High tax compliance costs would disadvantage small and independent Internet service providers, especially in rural areas. The legislation will promote innovation in information technologies by permitting Internet service providers to change and expand services without the distorting economic effects of taxation and without diverting funds from R&D to tax compliance. It will also stimulate the technology sector by preventing tax increases on consumers and businesses, promoting Internet access services, and stimulating investment in the industry.

And enactment of this legislation will promote U.S. competitiveness in digital content and online software and services. America currently dominates the world market in digital content, services, and software. If you want our industry to continue as the world leader, then America should resist extra tax and regulatory burdens.

By contrast, ending the moratorium would result in several harmful consequences. New taxes on Internet access could reach as much as $60 to $120 per year for the average consumer. Many consumers would face double taxation on Internet access services, on the service itself, as well as the telephone lines used to connect. The cost of providing Internet access services would increase because of the administrative costs necessary to collect, remit, and comply with tax regulations. And the price of taxes and the costs of compliance would profoundly impact virtually every aspect of Internet access services.

In closing, let me add that AOL and our industry are proud of the contributions we have made to national productivity, economic growth, technological innovation, and the empowerment of individual people to improve the quality of their lives. National tax policy that promotes these achievements is sound. There are many controversial tax policy issues now before Congress, but maintaining the moratorium against taxes on Internet access is not one of them.

Prior to the invention of the Internet, only a small portion of the world's population has had access to the world's libraries. Imagine the pace of human invention, going forward, when a child living in a rural community can connect the dots in ways that none of us have imagined.

I urge you to pass this legislation to ensure continued deployment of Internet access for all Americans.

Thank you.

[The prepared statement of Mr. Ripp follows:]

PREPARED STATEMENT OF JOSEPH A. RIPP, VICE CHAIRMAN, AMERICA ONLINE, INC.

Mr. Chairman, Members of the Committee, thank you for inviting America Online, Inc. to provide its perspective on the Internet Tax Nondiscrimination Act (S. 150 and S. 52). AOL strongly supports enactment of this legislation to make permanent the moratorium on state taxation of Internet access under the Internet Tax Freedom Act.

AOl's Experience

Since 1985, AOL has been the leading pioneer in providing a package of services that allow access to the content and other services offered over the Internet as well as access to proprietary content it and others have created. This is what constitutes Internet access services under the Internet Tax Freedom Act.

AOL's members now number over twenty-five million in the United States, more than any other online or Internet service provider. Our experience in this field has taught us several things about our industry and our members.

First, Internet access services, and the services and software that make access practically useful and navigable for people in their homes and offices, are still changing continuously to reflect growing knowledge of consumer interests and priorities, as well as ever evolving technology. Our entire industry is constantly developing new and faster transport technologies, more powerful and less expensive computers and personal communication devices, and Internet access services that are effortless and fulfilling, always with the interest and benefit of the member in mind. These advances occur against the backdrop of economic upheaval for the companies involved in the industry both directly and indirectly not just online and Internet service providers, but also dot-coms and telecommunications, cable and satellite companies that service our industry. We are all familiar with the wave of bankruptcies, divestitures and acquisitions in these sectors in recent months.

Second, broadband rollout remains critical to the expansion of Internet access services. Broadband rollout remains a high priority throughout the industry and for government at all levels. Why? Because the Internet has completely transformed the way Americans work, play, shop and gather information. A *new wave* of Internet accessibility, the availability of broadband (high-speed) access, has the potential to be *as revolutionary* as the first wave. Broadband access, through Digital Subscriber Lines (DSL) or cable modems allows users to send and receive enormous quantities of data, audio, video and voice communication. However, every technological revolution brings with it the possibility that some will be left behind.

Third, about half of the American people currently have access to Internet access services. That is an excellent record of achievement in a decade. But it means that we are only half way to our goal of providing these services to virtually all Americans. Certainly AOL and thousands of our competitors believe it is in our best business interests, the interests of individual people, and the national interest to make Internet access services as common as a television in the homes of America—not just as entrepreneurs but also because we believe the service we provide is critically important to full realization of an Information Society and the empowerment of individual people. Empowering individuals is the cornerstone of a democratic government.

Fourth, we know something about those Americans who do not yet have these services. They tend to be disproportionately poor, less affluent, less educated, elderly, ethnic minorities, or live in rural communities. AOL has been working hard to reach out to these groups through such initiatives as prepaid arrangements, where members purchase a fixed amount of time online without further commitment. AOL also offers a new client to the Hispanic marketplace-one that prompts a prospective member to choose instructions in English or Spanish, somewhat akin to what many ATM screens do today. Once these subscribers are logged in, they will receive a Welcome Screen that includes special AOL Latino content. AOL has also recently launched "AOL Black Focus," a comprehensive new area on the AOL service that combines content and information from an African American perspective with an engaging online community. These new efforts demonstrate how AOL recognizes that it cannot speak to its 25+ million members in the same voice . . . we have to reflect our diverse membership.

Fifth, we believe several factors will play a critical role in reaching this remaining 50 percent of Americans: (1) technological enhancements that make access and hardware less expensive and more ubiquitous, (2) keeping online services and Internet access affordable for average consumers, and (3) constant upgrading of basic services to make each person's online experience more practically useful, safe and entertaining.

National tax policy will directly impact our industry's ability to achieve the objectives I have outlined. It will have a substantial financial impact on the tens of millions of American consumers who already are logged on. It will also have serious implications for our ability to reach the 50 percent of Americans who are not logged on. And it will impact our industry directly and significantly as well as the quality of the service we provide.

The Cost of Tax Compliance

By way of background, AOL began as a small company providing online services only to users of IBM, Apple and Commodore computers as early as 1985. In the following years, AOL's explosive growth caused it to emerge as a national dial-up provider of Internet access services. We quickly gained members from every state and virtually every city in America. By 1997, AOL had over seven million members in the United States. All of these members gained entry to AOL's services through AOL's data centers located in northern Virginia, which they generally accessed through computer modems and their telephone lines. Reflecting on this history, AOL has been both a small online service provider and a nationwide provider of Internet access services, with the respective challenges and benefits of each, within a relatively short time frame.

Also by 1997, several state and local governments had begun to enact differing taxes on online and Internet access services. Tacoma, Washington, for example, implemented a plan to tax these services as a telephone utility in September of 1996. Chandler, Arizona began imposing a local utility tax on these services. The state of Connecticut, on the other hand, started to impose a 6 percent sales tax on Internet access service on the theory that it constituted a "computer and data processing" service. A handful of other states, sometimes through their legislatures but much more often through administrative interpretations of tax administrators, also began to enact or consider new taxes on Internet access services. The enactments and debates, however, involved tax theories, tax rates and compliance and reporting regulations that varied greatly from state to state.

The prospect of hundreds or even thousands of disparate taxes, tax rates and systems being heaped upon online and Internet service providers and their customers presented a real dilemma. Because some states' tax administrators mistakenly equated these services with telecommunications, online and Internet service providers faced the specter of potentially filing over 55,000 different tax returns each year across thousands of jurisdictions, just like a national telephone company. Thousands of online and Internet service providers, many of them small entrepreneurial operations, determined that they could not practically comply with thousands of state and local tax regulations, much less manage the purely practical function of collecting taxes from each customer and then remitting the taxes to state and local governments.

It was no different for AOL, particularly during the rapid membership growth of the mid to late 1990s. Even for a major national provider like AOL, the prospect of complying with thousands of state and local tax regimes was daunting. The tax rules varied greatly from jurisdiction, to the extent any meaningful tax rules had been published at all. Furthermore, many of these rules based the amount of taxes and the fact of taxation on customer location, a fact that is often impossible to determine for members using the most popular dial-up access method. While these rules may have had some applicability to telephone companies, which have years of experience complying with public utility regulation, they are burdensome and inapplicable to a company such as AOL.

These costs and difficulties would continue today. We estimate that taxes on the full amount of the basic monthly dial-up subscription service for typical members would increase its cost by approximately $2 to $3 per month on basic dial-up service. For higher cost broadband service, the cost could be an additional $5 to $10 per month.

The cost and practicalities of tax compliance would have to be figured into each new technological and service enhancement and, in some cases, would alter our decisions. These costs do not even account for the burdensome and costly litigation that AOL has been forced to undertake to defend against multimillion dollar tax assessments by several states claiming to be grandfathered under the ITFA.

While a large, national company like AOL might be able to muster the resources to comply with a panoply of tax regulations, it would come at great cost. The cost of compliance would negatively impact our customers, our shareholders, and drain resources from technological and service enhancements. But even with tremendous effort, no dial-up ISP can reliably identify customer location at the time of use, a common feature of state tax rules. At a time of transition in the industry, no com-

pany needs this sort of additional burden and cost, without providing any benefit but simply greater fees, to its customers.

Benefits Achieved Under the Internet Tax Freedom Act

In 1998, Congress passed the Internet Tax Freedom Act to halt the proliferation of state and local taxes on Internet access services. In the beginning, the act of Federal preemption of state taxation was controversial. Accordingly, Congress acted carefully and incrementally:

(1) Congress enacted a moratorium to prohibit taxation for a period of three years;

(2) Congress "grandfathered" states that already had enacted some form of tax on Internet access services to provide them time to alter or reverse their policies (or see if Congress might eventually reverse itself); and

(3) Congress established the Advisory Commission on Electronic Commerce to study Internet tax policies comprehensively and report back to Congress during the three-year moratorium period.

The ITFA passed overwhelmingly in 1998, and President Clinton signed it into law. Subsequently, the Advisory Commission on Electronic Commerce (ACEC) studied Internet taxation for a year. AOL—as well as Time Warner—participated actively through their separate seats on the ACEC (at the time, AOL and Time Warner had not merged). The ACEC encountered significant controversy on certain tax policies, but one issue never proved to be controversial: the moratorium on taxation of Internet access services. No one ever articulated a justification or defense of allowing thousands of state and local tax jurisdictions to burden Internet access service by taxing it. Access taxes were never debated and the Commission's final Report (April 2000) included, by a clear majority, a proposal for Congress to permanently extend the moratorium on Internet access taxes and to make it national in scope.

In 2001, Congress again overwhelmingly passed a two-year extension of the moratorium, and President Bush signed it into law. Through Treasury Secretary Snow's letter of May 14, 2003, the Administration has signaled its continued support for this legislation.

We have operated under a national policy that prohibits state and local taxes on Internet access for five years. During that time, several states have abolished or significantly curtailed the taxes they had enacted on Internet access services. For example, Connecticut, Iowa, and the District of Columbia eliminated the taxes they claimed were due on these services. A state court in Tennessee recently ruled that Prodigy's online services were not subject to the telecommunications tax assessed by the Department of Revenue. South Carolina has voluntarily followed the Federal moratorium. The Washington State legislature overturned the City of Tacoma's tax.

We have made great strides in the past five years at improving online services, expanding service to more places and increasing the number of people logged on the Internet. In the process, we also have been successful in extending digital opportunities to more Americans of poorer means, less education and less affluence. Indeed, I can say unequivocally that we would not have as many Americans logged on today, through a diverse array of providers and ISPs, had the Congress never enacted the ITFA. However, as I mentioned earlier, the 50 percent of Americans who are not logged on still are disproportionately of harder to reach demographic groups, and they are the most likely to be hurt by additional tax costs. Moreover, the quality and nature of Internet access services would be significantly different today had ITFA never been enacted. The ITFA has been beneficial in terms of expanding and improving Internet access service.

And most significantly, while I cannot speak for all state and local government lobbies, I am confident in observing that a general consensus appears to have emerged among most interest groups, industries and ideological sides of the debate that a national tax policy prohibiting a panoply of state and local tax burdens on Internet access services is prudent and constructive.

The Internet Tax Nondiscrimination Act

That brings us to today's hearing and this Committee's consideration of the Internet Tax Nondiscrimination Act (S. 150 and S. 52). Passage of the Internet Tax Nondiscrimination Act will have several key benefits:

- Passage of S. 150 and S. 52 will promote digital opportunities for the 50 percent of Americans who do not currently have Internet access services. Taxes would only increase their costs and frustrate the national goal of providing these services for all Americans.

- It will protect American consumers and online and Internet service providers from the additional costs that would be necessary to comply with a multi-jurisdictional tax system involving thousands of different and conflicting state and local tax rates, regulations, collection and remittance requirements, audits, administrative costs and litigation. Moreover, taxes on online and Internet services are inherently difficult to administer because dialup customers can log on from any location, and their location is often impossible to determine.
- S. 150 and S. 52 will promote competition in the industry. High tax compliance costs would disadvantage small online and Internet service providers and diminish competition. States and localities have imposed inconsistent tax regulations, increasing the cost of multi-jurisdictional compliance for online and Internet access service providers. Onerous compliance costs will inhibit full roll out of competitive Internet access services to all Americans, especially in rural areas. Small independent and rural online and Internet service providers will be at a competitive disadvantage in complying with complex multi-jurisdictional tax regulations and will find it cost-prohibitive to expand services to additional states or localities.
- S. 150 and S. 52 will promote innovation in information technologies. Tax costs will necessarily divert resources from innovation and service to regulatory compliance. Taxes also will increase the price of any service enhancements. Left free of widespread taxation, online and Internet service providers can innovate and expand services without the distorting economic effects of taxation.
- Passage of S. 150 and S. 52 will stimulate the technology sector of the economy by (1) preventing tax increases on consumers and businesses, (2) promoting Internet access services, and (3) stimulating investment in the industry.
- S. 150 & S. 52 promote U.S. competitiveness in digital content and online software and services. America currently dominates the world market in digital content, services and software. The Internet Tax Nondiscrimination Act promotes U.S. competitiveness in the world marketplace by providing broad tax and regulatory protection for Internet and online access and related software and services that make Internet access services accessible for average Americans. The more accessible these services become, domestic production of online content and services increases. By comparison, the European Union now imposes VAT taxes on Internet access and online content and services. Already the EU policy has negatively impacted consumers' use of online and Internet access services in European countries. If you want our industry to continue as the world leader in this industry, then America should resist the EU paradigm.

By contrast, *failure* to extend to the moratorium will result in several harmful consequences:

- State and local governments will inevitably impose new and complex taxes on each consumer's monthly Internet access service charges;
- Such taxes could amount, in some states, on some high-end broadband services, to as much as $5 to $10 per month, or as much as $60 to $120 per year. According to the Information Technology Association of America (ITAA), failure to pass the Internet Tax Nondiscrimination Act will raise the cost of Internet access services (for the providers as well consumers), and thereby suppress demand for broadband and network-enabled innovations at "the edge of the network."
- Many consumers will face double taxation on Internet access services—on the service itself as well as the telephone line so often used to connect to the provider;
- The cost of providing Internet access services will increase because of the administrative costs necessary to collect, remit and comply with tax regulations; and
- The price of taxes as well as the business cost of tax and regulatory compliance will profoundly impact, in ways obvious and subtle, virtually every aspect of the provision of Internet access services-the cost of service delivery for providers, price for each consumer, resources available for investment in further technological enhancements, the ability of access providers to expand service into new tax jurisdictions, and the cost benefit analysis of certain service enhancements—tax policy affects each of these market facets.

In short, AOL urges Congress to pass the Internet Tax Nondiscrimination Act for all of the reasons I have mentioned.

Amendments That Have Been Discussed in Public Debate

During the current consideration of S. 150, S. 52 and the companion bill in the House, H.R. 49, AOL has sought actively to maintain the broad industry support for prompt enactment of this legislation. This interaction has identified two additional critical points. First, experience under the existing language of the Internet Tax Freedom Act has shown that some states have sought to interpret its language in ways that deny protection from taxation based on the use of certain types of new technology to provide Internet access services. We can expect to see continuing changes in the technologies used to provide Internet access services in the coming years, if not months. Securing the objectives of the moratorium on state taxation, namely stimulation of a vibrant and broadly available group of Internet access services, requires that the moratorium be technology neutral. AOL would support technical changes to the existing language of the Internet Tax Freedom Act that ensure such technology neutrality.

Second, some state tax administrators and others have argued that the scope of the tax prohibition should be modified to expose the basic software and content services provided as part of Internet access services to taxation while granting tax freedom to only a minimalist notion of Internet access service. This proposal would fundamentally shift the status quo in the industry, where a variety of online and Internet service providers offer a range of software, content and services as most appropriately suits their membership. To consumers, they all fall under the conventional understanding of Internet access services. Furthermore, all of the benefits and detriments of tax policy outlined above apply regardless of whether an ISP must tax all of its service or only half of its service. And the practical problems inherent in such a "partial-service tax free vs. partial-service taxed" system should are obvious. For example, determining the fee attributable to different aspects of these services would be arbitrary and expensive, fundamentally an exercise without any other business purpose and indeed contrary to the very purpose of the ITFA.

Similarly, some businesses would like to amend the scope of the tax prohibition so as to advantage the business models they currently employ or that they intend to employ in the future. Such proposals typically involve narrowing the moratorium to produce state taxation of other business models. AOL urges the rejection of all such proposals. The success of a given approach to commercializing Internet access services should depend only on whether the approach meets the current needs of Internet users. Such success should not result from other approaches being burdened by state taxation. Therefore, AOL urges that the moratorium remain broad in scope, as it has been since the original 1998 enactment.

Third, some people have suggested that the moratorium not be permanent or national in scope. AOL would urge the Senate to resist amendments to simply extend the moratorium for another period of years requiring the issue to be continuously lobbied for what is generally considered a widely accepted idea. Moreover, during the last five years of temporary moratoriums, nobody has ever articulated a time when exposing Internet access service to a complex and regressive multi-jurisdictional tax system would be beneficial for interstate Internet access service and the tens of millions of Americans who use them. Therefore, the consumers of America and access service providers deserve a national and permanent moratorium.

Conclusion

In closing, let me add that AOL and our industry are proud of the contributions we have made to national productivity, economic growth, technological innovation and the empowerment of individual people and improvement in the quality of their lives. National tax policy that promotes these achievements is sound. Accordingly, the moratorium extension contemplated by S. 150 and S. 52 should receive prompt favorable action by this Committee and the Senate as a whole. There are many controversial tax policy issues now before Congress, but the moratorium against taxes on Internet access services is not one of them.

Thank you.

The CHAIRMAN. Thank you, sir.

Mr. Misener, welcome back.

STATEMENT OF PAUL MISENER, VICE PRESIDENT FOR GLOBAL PUBLIC POLICY, AMAZON.COM, INC.

Mr. MISENER. Thank you, sir. I appreciate that very much. Good morning.

My name is Paul Misener. I am Amazon.com's Vice President for Global Public Policy. Thank you very much for inviting me to testify today. And thank you, especially, Mr. Chairman, and you, Senator Allen, and you, Senator Wyden, for your leadership on this specific issue that we are going to be discussing this morning.

Mr. Chairman, on behalf of our customers and company, Amazon.com supports extending the Internet Tax Freedom Act moratorium. Congress adopted this wise policy five years ago, and there is no good reason to deviate from it now. We also support the decision to split consideration of the moratorium policy from the entirely separate and intricate constitutional matter of remote sales tax collection on which Amazon.com has been working cooperatively with the states for several years.

Mr. Chairman, Amazon.com believes that Congress made the correct policy choice in 1998, when it established the Internet Tax Freedom Act's moratorium. At that propitious moment, when the World Wide Web was but half its current age, e-commerce was widely celebrated but little understood; and, thus, there was significant potential for state and local authorities to make uninformed decisions with respect to Internet taxation.

Although the moratorium does not affect Amazon.com directly, it has been very beneficial to American consumers, including Amazon.com's customers, by protecting them from onerous taxation. The moratorium also has given companies that provide e-commerce infrastructure and services the certainty of tax policy necessary for building the Web into the ubiquitous, reliable, and affordable medium it is today. Moreover, the moratorium gave the states time to become familiar with the Internet and its myriad benefits. Because we foresee no reason for the extant national moratorium policy to change, we support making it permanent.

Mr. Chairman, the issue of whether and how Congress should permit states to require out-of-state sellers to collect tax on sales to in-state consumers is often confused and conflated with the moratorium policy. As many of you have said this morning, it is, however, a completely separate matter and presents Congress with the gravity of a fundamental constitutional right and the nearly mind-numbing detail of state sales taxation. Please allow me to elaborate.

The commerce clause of the United States Constitution establishes an essential protection that bars the states from encumbering interstate commerce without specific congressional approval. No less an authority than James Madison opined that the most important negotiation at the Philadelphia Convention involved this protection.

On the matter of state sales taxation, the Supreme Court has held that the commerce clause bars states from requiring out-of-state sellers to collect taxes on sales to a state's residents unless these so-called "remote sellers" have substantial nexus with that state. Thus, a fundamental constitutional protection, not some prior policy choice, currently bars states from requiring remote sellers without nexus to collect tax.

Not only is the separate issue of remote sales tax collection, at base, a grave constitutional matter, it also involves important yet nearly mind-numbing detail. Nationwide, there are over 7,500 ac-

tive local sales tax jurisdictions that include not just cities, states, and counties, but also school, transportation, and mosquito-abatement districts. Each of these jurisdictions has its own tax rates—rules and basic definitions.

Mr. Chairman, the remote sales tax collection issue is so constitutionally grave and intricately detailed that thorough congressional hearings and deliberations are absolutely essential, and we applaud your efforts to call those later this year. Indeed, for Congress to consider overturning two Supreme Court decisions on such a fundamental constitutional protection, the Senate and House must be presented all the salient facts and opinions on the matter.

In just a brief preview of what undoubtedly will be discussed in great detail at upcoming hearings, please recognize that the states have not yet simplified their tax codes in a constitutionally meaningful way. You may have heard, or soon will hear, the claim that some large number of states have adopted the Streamlined Sales-and-Use Tax Agreement and, thus, the long-awaited simplification has occurred.

This claim is misleading on three fundamental points. First, the simplifications included in the agreement are modest, at best, and certainly are not adequate for Congress to overturn the Supreme Court's decisions. Second, key states have failed to adopt key provisions of the agreement. And, third, in many states the modest changes in the agreement that actually have been enacted are not set to take effect until as late as the end of 2005. Progress is, indeed, inadequate, inconsistent, and often postponed.

Future hearings also will reveal that the seemingly innocuous proposal to exempt small businesses from any remote sales tax collection requirement actually would create a sales tax collection loophole for large companies whose revenue sources are divided into many hundreds or thousands of small components.

In conclusion, Mr. Chairman, Amazon.com supports extending the Internet Tax Freedom Act moratorium. Congress adopted this wise policy 5 years ago, and there is no good reason to deviate from it now. We also support the decision to split consideration of the moratorium policy from the entirely separate and intricate constitutional matter of remote sales tax collection.

Thank you, again, for inviting me to testify. I look forward to your questions. And I ask that my entire written statement be included in the record.

The CHAIRMAN. Without objection.

[The prepared statement of Mr. Misener follows:]

PREPARED STATEMENT OF PAUL MISENER, VICE PRESIDENT, GLOBAL PUBLIC POLICY, AMAZON.COM

Good morning, Chairman McCain, Senator Hollings, and members of the Committee. My name is Paul Misener. I am Amazon.com's Vice President for Global Public Policy. Thank you very much for inviting me to testify today; I respectfully request that my entire written statement be included in the record of this hearing. Thank you also—and, in particular, thank you Senators Allen and Wyden—for your leadership on the issues we will discuss this morning. Mr. Chairman, on behalf of our customers and company, Amazon.com supports extending the Internet Tax Freedom Act moratorium; Congress adopted this shrewd policy five years ago, and there is no good reason to deviate from it now. We also support the decision to split consideration of the moratorium policy from the entirely separate and intricate con-

stitutional matter of remote sales tax collection, on which Amazon.com has been working cooperatively with the states for several years.

The Internet Tax Freedom Act Moratorium Should be Extended

Mr. Chairman, Amazon.com believes that Congress made the correct policy choice in 1998, when it established the Internet Tax Freedom Act's moratorium on state and local taxes on Internet access; bit taxes; and new, multiple or discriminatory taxes on electronic commerce (the "Moratorium"). At that propitious moment—when the World Wide Web was but half its current age—ecommerce was widely celebrated but little understood and, thus, there was significant potential for state and local authorities to make uninformed decisions with respect to Internet taxation. Although the Moratorium does not affect Amazon.com directly, it has been very beneficial to American consumers, including Amazon.com's customers, by protecting them from onerous taxation. Many statistics—including the fact that the percentage of Americans who use the Internet increased from 33 percent in late 1998 to 54 percent by the fall of 2001—help confirm the wisdom of Congress' decision. The Moratorium also has given companies that provide ecommerce infrastructure and services the certainty of tax policy they needed in order to make the substantial nationwide investments necessary for building the Web into the ubiquitous, reliable, and affordable medium it is today. Moreover, the Moratorium gave the states time to become familiar with the Internet and its myriad benefits. Whereas the Internet five years ago may have been seen as a novel source for extra government revenue, today it is accepted as an essential societal good undeserving of additional layers of taxation. Indeed, unlike some activities that policymakers often discourage by additional taxation, it now is widely recognized that Internet use should not be intentionally reduced in this way. We think it somewhat unlikely, therefore, that states would now, were the Moratorium to expire, choose to heap layers of tax burdens on the Internet. Yet, because allowing states to do exactly that would be the only reason for discontinuing the Moratorium, we support maintaining it. And, because we foresee no reason for the extant national Moratorium policy to change, we support making it permanent—subject, of course, to subsequent Congressional repeal if currently unforeseeable circumstances were to render the policy unsound at some point in the future.

Sales Tax Collection is an Entirely Separate and Intricate Constitutional Matter

Mr. Chairman, the issue of whether and how Congress should permit states to require out-of-state sellers to collect tax on sales to in-state consumers is often confused and conflated with the ITFA Moratorium policy. It is, however, a completely separate matter. And, unlike the policy choices Congress made to establish, then extend the Moratorium, the remote sales tax collection issue simultaneously presents Congress with the gravity of a fundamental constitutional right and the nearly mind-numbing detail of state sales taxation. For these reasons, Amazon.com supports considering remote sales tax collection separately. Please allow me to elaborate. The Commerce Clause of the United States Constitution establishes an essential protection that bars the states from encumbering interstate commerce without specific Congressional approval. No less an authority than James Madison, the Father of our Constitution, opined that the most important negotiation at the Philadelphia Convention involved this protection. On the matter of state sales taxation, the Supreme Court has held—in the 1968 Bellas Hess and 1992 Quill decisions—that the Commerce Clause bars states from requiring out-of-state sellers to collect taxes on sales to a State's residents unless these so-called "remote sellers" have "substantial nexus" with that State. Otherwise, held the Court, the current sales tax regime is so complicated that a collection requirement would impose an unconstitutional burden on remote sellers. Thus, a fundamental constitutional protection, not some prior policy choice, currently bars states from requiring remote sellers without nexus to collect sales tax, and the present debate is fundamentally about whether remote sellers will continue to be afforded this protection. Not only is the separate issue of remote sales tax collection at base a grave constitutional matter, it also involves important yet nearly mind-numbing detail. Nationwide, today there are over 7,500 active local sales tax jurisdictions that include not just states, cities, and counties, but also school, transportation, and mosquito abatement districts. Each of these jurisdictions has its own tax rates, rules, and basic definitions; and their geographic boundaries are often vague or virtually unknowable for anyone outside the locality. The issue also involves interstate compacts and ongoing governance mechanisms; combined audit processes; the creation of a national database of jurisdictions and rates; vendor compensation; sales tax holidays; and the bundling of goods and services. Put bluntly: details matter. In addition to these grave and detailed constitu-

tional considerations, the remote sales tax collection issue involves a few associated policy matters, such as whether remote sales (which tend to use fewer local services, cause less pollution, and save citizen time) should be taxed the same way as local sales, especially when brick and mortar retailers regularly receive local tax abatements and need only collect at the tax rates and rules of their stores' locations, not their customers' homes.

The Gravity and Intricacy of the Sales Tax Issue Necessitate Thorough Deliberation

Mr. Chairman, the remote sales tax collection issue is so constitutionally grave and intricately detailed that thorough Congressional hearings and deliberations are absolutely essential. Indeed, for Congress to consider overturning two Supreme Court decisions on such a fundamental constitutional protection, the Senate and House of Representatives must be presented all the salient facts and opinions on the matter. Amazon.com has been working cooperatively with the states on this issue for several years. Unlike the stridently anti-tax position incorrectly ascribed to our company on occasion, we long have maintained that we would be willing and able to collect tax on remote sales so long as the relevant state codes are actually simplified. In other words, if the unconstitutional burden found in Bellas Hess and Quill is truly removed, we would not oppose Congress overturning the Supreme Court decisions. Not surprisingly, therefore, we have been working constructively with the states to ensure that their efforts lead to true simplification. Gary Locke, Governor of Amazon.com's home state of Washington and a strong proponent of sales tax simplification and eventual mandatory collection by remote sellers, appointed Amazon.com to be one of Washington State's two private sector representatives to the Streamlined Sales Tax Project ("SSTP"). Based on our experiences in this collaboration with the States, and as the largest online retailer in America, we look forward to sharing the details of our knowledge and ideas with Congress at upcoming hearings.

Upcoming Hearings Will Reveal that the States Have Not Yet Simplified Adequately

Mr. Chairman, in just a brief preview of what undoubtedly will be discussed in great detail at upcoming hearings, please recognize that the states have not yet simplified their tax codes in a constitutionally meaningful way. You may have heard, or soon will hear, the claim that some large number of states (the Streamlined Sales Tax Implementing States—"SSTIS"—which approved the SSTP's work) have adopted the Streamlined Sales and Use Tax Agreement (the "Agreement") and, thus, the long-awaited simplification has occurred. This claim is misleading on three fundamental points. First, the simplifications included in the Agreement are modest, at best, and certainly are not adequate for Congress to overturn the Supreme Court's decisions. The states have thus far avoided the tough choices that would produce true simplification. For example, they have not solved the thorny problems of vendor compensation, sales tax holidays, or the bundling of goods and services or of physical and digital goods. Nor have they developed an interstate compact with an ongoing governance mechanism, a combined audit process, or a national database of jurisdictions and rates. In sum, and as surely will be revealed in detail in upcoming hearings, the Agreement simply is not yet ready for prime time. Second, key states have failed to adopt key provisions of the Agreement. For example, some of the largest states in the Union—California, Texas, Illinois, and Washington—have longstanding rules that tax goods at the source of the sale, and they have no plans to change these rules as is required by the Agreement. Under Texas law, a Houston consumer who buys a lamp from a Dallas seller must pay both a state sales tax that is remitted to Austin and a local sales tax that is charged at the Dallas rate and remitted to the Dallas city government. This is the so-called "sourcing" approach to sales taxation. But the Agreement is fundamentally based on a "destination" approach, whereby sales are taxed at the consumer's—not the seller's—location. If Texas were to adopt the Agreement, the sale of the lamp by the Dallas seller to the Houston consumer suddenly would be locally taxed at the Houston rate and the proceeds would be sent to the Houston city government. The redistribution of tax assessments and revenue among cities, counties, legislative districts, and other areas within sourcing states would potentially be enormous, and at best unpredictable, with various in-state winners and losers. Key sourcing states in the SSTP—Texas and Washington, for example—have recognized this huge economic and political problem and each has deferred adoption of the destination approach pending future studies that, in Texas, are not due until the end of 2004. And, of course, another key sourcing state, California, has not participated in the SSTP and, if it does participate in the future, faces the extant destination-based Agreement, which may

be amended only by supermajority vote. Thus, not only have state tax representatives collectively avoided the hard choices necessary to meet constitutional strictures; state legislatures have individually balked at even the modest changes the SSTP has proposed. Third, to make matters even worse, in many states, the modest changes in the Agreement that actually have been enacted are not set to take effect until the middle of next year, or even as late as the end of 2005. Progress is, indeed, inadequate, inconsistent, and often postponed. Future hearings also will reveal that the seemingly innocuous proposal to exempt small businesses from any remote sales tax collection requirement actually serves as a disincentive to the states in their simplification efforts. Such an exemption—often proposed for companies with less than $5 million annual revenue—would create an obvious sales tax collection loophole for large companies whose revenue sources are divided into many hundreds or thousands of small components. More fundamentally, a small seller exemption also removes states' incentive to simplify their sales tax codes, because only the big sellers would need to comply. But if a seller with yearly sales of $4.9 million (or even one fiftieth that amount) cannot figure out the collection system, it certainly is not simple. Put another way, a truly simplified sales tax collection system should be manageable even to businesses annually making one hundred thousand dollars. Lastly, although reasons behind actions or inactions are inherently difficult to divine, hearings may also expose why the states have not yet simplified adequately. There probably are two essential reasons. First, the SSTP was not clearly chartered as an effort to simplify tax codes enough to have Congress overturn the Supreme Court. It began instead as a collegial effort by the states to improve their tax systems merely for the sake of improvement. In such circumstances, any progress is good and welcome. But, at some moment last year, the SSTP almost imperceptibly metamorphosed into an effort to convince Congress that it should overturn the Court, with or without real simplification. One prominent governor, addressing the SSTP in a speech last April, said, "We want to keep Congress from over-thinking on this issue . . .." Hopefully, this view is rare, for Congress deserves to receive all the relevant information and opinions. The second key reason why states have not yet made the tough choices may be the fact that the potential revenue is so modest. In contrast to some of the outlandish estimates of huge online markets and potential sales tax revenue that you may have heard a few years ago or even recently, the forgone revenue on ecommerce sales is currently at most a meager $2.4 billion per year nationwide. We certainly wish the potential tax revenue were higher—because our sales would be proportionately larger—but it is not. Suggestions that, because the states are in a budget crisis, Congress must act very quickly to allow the states to require remote sellers to collect tax are well-meaning but unfounded: state budget shortfalls dwarf potential tax revenue from remote online sales; there is plenty of time to get simplification right.

Conclusion

In conclusion, Mr. Chairman, Amazon.com supports extending the Internet Tax Freedom Act Moratorium. Congress adopted this shrewd policy five years ago, and there is no good reason to deviate from it now. We also support the decision to split consideration of the Moratorium policy from the entirely separate and intricate constitutional matter of remote sales tax collection, and we hope to have the opportunity to testify at a subsequent hearing on the details of this topic. Thank you again for inviting me to testify. I look forward to your questions.

The CHAIRMAN. Welcome, Mr. Hamilton. Mr. Beshears, we'll save you for last. Thank you.

Mr. Hamilton, welcome.

STATEMENT OF BILLY HAMILTON, PAST PRESIDENT, FEDERATION OF TAX ADMINISTRATORS; DEPUTY COMPTROLLER, STATE OF TEXAS

Mr. HAMILTON. Mr. Chairman, Members of the Committee, good morning. My name is Billy Hamilton, and I'm Deputy Comptroller of Public Accounts, in Texas, a position I've held for 11 years. I'm also a member of the executive committee of the Multistate Tax Commission, and am a past President of the Federation of Tax Administrators, on whose behalf I appear today.

And I also would like to have the full text of my remarks entered into the record of today's hearing.

The CHAIRMAN. Without objection.

Mr. HAMILTON. I am here today to discuss the proposal to extend the moratorium on state taxation and Internet access charges. The Internet Tax Freedom Act was implemented in 1998, as you know, as a temporary means of allowing a new form of technology to gain a foothold in the mainstream of American life without the encumbrance of taxes. The authors of the original law highlighted their hope that keeping Internet access free of taxes would allow more Americans to afford this basic access to the Internet.

The fledgling industry argument is no longer relevant. The purchase or supply of Internet access services in states that tax services has not been adversely affected by the tax, and the Internet continues to grow. Electronic commerce is now a mature sector of the U.S. and international economy. And while we wholeheartedly support its continued expansion as a fast and efficient avenue of commerce, continuing the preemption of taxation simply provides a special position for this particular communications medium that ultimately leads to discrimination among firms in the Internet access and communication sectors. Thus, it may be time to reexamine the intent of the original act to determine whether the special tax treatment of Internet access is still necessary or whether we can come up with an alternative solution to put in its place.

I think a more fundamental point is that the states attempt to exercise common sense in most instances when it comes to taxing business and commerce. Taxation of Internet access is a state issue, which Texas and every other state should be allowed to address. I do not believe that there was ever a threat of highly discriminatory taxes on the Internet by the states. Rather, many states seek to provide a tax advantaged home for Internet companies as an economic development strategy. I do not believe, for example, that the Texas legislature would be inclined to pass special taxes in this area even if strictures were lifted tomorrow. Members of our legislature understand and value the unique qualities of the Internet as a means of commerce, but they also understand that it must be treated like other businesses operating in their states, many of whom pay state and local taxes and are, in every respect, good citizens of their community.

While the MTC and FTA maintained a neutral position on congressional action in the original Tax Freedom Act and its successor, the Internet Tax Nondiscrimination Act, both organizations have provided Congress several recommendations with regard to specific provisions of the act, should you choose to extend the law.

We recognize, first, that many in Congress have different views on whether the current moratorium should be extended permanently or for a short period of time. On this point, we recommend that if Congress chooses to extend the act, it should do so for no more than 2 years. Further, if the act is extended, Congress should undertake a thorough review of its impact on state and local revenues and the presence of unintended consequences due to changes in technology.

Second, the MTC and FTA believe that any extension of the current law should preserve the grandfathered ability of the limited number of states that currently impose the tax on charges for Internet access. Currently, nine states impose taxes that are pro-

tected. Repealing the grandfather clause would disrupt their revenue streams at a time when I think we all know every state is struggling to balance its budget.

Third, the definition of "Internet access" contained in the act should be rewritten to ensure equity among various types of access providers and among types of communications services. It should also eliminate opportunities to bundle otherwise taxable content into a single package of Internet access in a manner that would prevent the imposition of taxes that would otherwise be applicable.

Any extension of the act should not be accompanied by provisions or separate legislation that grants more favorable state and local tax treatment to commerce conducted electronically over commerce conducted by other means.

The definition of "discriminatory taxes" contained in the legislation should be amended to ensure that it does not allow a seller, through affiliates, to avoid a tax collection obligation in a state, even though the seller has a substantial nexus in the state. These provisions, in the original act, were intended to ensure that merely accessing products of an out-of-state seller via an in-state service provider would not be considered to create nexus for an out-of-state seller.

When the law was written, these provisions were not considered problematic. However, as the electronic-commerce industry has evolved, the potential for this issue to arise has grown and should be examined carefully.

The MTC and FTA believe that changes in considerations must be addressed, and both organizations are available to assist Congress in any way in analyzing the issues as the debate goes forward.

Now, I would like to turn your attention briefly to how the Texas legislature addressed the issue of taxation in Internet access and why this is a unique solution that deserves consideration by Congress for possible nationwide implementation.

By 1997, Internet access was already being used by some Texas businesses and was, at the time, classified as taxable information services by the state. In the course of heated debate over proper state and local and Federal taxation of the Internet that surrounded the 1998 Act, Texas tax law drew criticism. In response, the comptroller convened a broad-based working group of industry leaders, traditional businesses which had an Internet presence, the legal and accounting professions, who specialized in state tax policy, at our office to suggest and formulate potential techniques to address Texas' taxation of Internet transactions.

Our working group concluded that Internet access was taxable under the statute, and made various recommendations. One of the recommendations was to repeal the tax on Internet access. But, if that were not feasible, for financial reasons, the working group recommended that we seek clarification and simplification from the legislature.

This clarification occurred in the 1999 legislation, where our legislature, upon further review and recognition, decided that to treat Internet access charges as a separate category from information services under the Texas tax code. However, the legislature and the comptroller were mindful of the benefits of this new technology and

the desire to ensure that every Texas resident was able to obtain tax-free basic access to the Internet.

To achieve this goal, the legislature passed Senate Bill 441 that exempts taxation of the first $25 of Internet access charges. Our state law has not changed that enactment. We still provide the first $25 of Internet access tax free to Texas residents. And hundreds and thousands, if not millions, of Texas residents have taken advantage of this option.

In 2000, Comptroller Carole Keeton Strayhorn convened an Electronic Commerce and Technology Advisory Group that formed a review of the policies affecting taxation of e-commerce in Texas and to make recommendations that would support expansion of Internet access to people in areas currently without adequate access, while ensuring that Texas remains competitive in the marketplace, in comparison with other states.

Comptroller Strayhorn took the group's advice and came out with a number of recommendations. One was to seek an increase in the Internet access exemption. However, due to budget constraints, the Texas legislature was unable to increase the exemption at this time. On the other hand, even under a lot of budget pressure, they did not do away with the exemption.

My purpose in providing a brief background as to how Texas obtained its solution is to demonstrate that our solution was not a one-sided decision; it was a solution that was created by the comptroller's office working closely with a cross-section of industries and professionals. Despite the Texas legislature's inability this year to increase the exemption, it does not in any way undermine the widespread support from both taxpayers and business to a solution we have implemented. And we have found that the growth rate of access in the Internet in the state to be on par with that achieved in other parts of the country.

The Texas solution is unique, but we believe it is one that Congress should seriously consider as it analyzes the need for extending the current law and tries to deal with competing requests for changes in the definition of Internet access. It provides a simple but fair method of ensuring that citizens have tax-free access to basic Internet services, while immediately resolving many of the questions that Congress continues to wrestle with regarding purported differential treatment of Internet service providers and bundled content.

I hope the information I've provided is helpful to the Committee and to the Senate, as it continues its debate on this issue. I would also be happy to answer any questions.

[The prepared statement of Mr. Hamilton follows:]

PREPARED STATEMENT OF BILLY HAMILTON, DEPUTY COMPTROLLER, STATE OF TEXAS

Mr. Chairman, Members of the Committee, good morning. My name is Billy Hamilton, and I am Deputy Comptroller of the Texas Comptroller of Public Accounts, a position I have held for 11 years.

I am also a member of the Executive Committee of the Multistate Tax Commission and a past President of the Federation of Tax Administrators, on whose behalf I appear today. The MTC is an organization of state governments that works with taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. Forty-four states and the District of Columbia participate in the Commission. The FTA is an association of the principal tax adminis-

tration agencies in each of the 50 states, the District of Columbia and New York City.

I am here today to discuss a proposal to extend the moratorium on state taxation of Internet access charges. The *Internet Tax Freedom Act* was implemented in 1998 as a temporary means of allowing a new form of technology to gain a foothold in the mainstream of American life without the encumbrance of taxes. The authors of the original law highlighted their hope that keeping Internet access free from taxes would allow more Americans to be able to afford basic access to the Internet.

The "fledgling industry" argument is no longer relevant. The purchase or supply of Internet access services in the states that tax services has not been adversely affected and use of the Internet continues to grow exponentially. Electronic commerce is now a mature sector of the U.S. and international economy, and while we wholeheartedly support its continued expansion as a fast and efficient avenue of commerce, continuing the preemption from taxation simply provides a special position for this particular communications medium that ultimately leads to discrimination among firms in the Internet access and communications sector. Thus, it may be time to re-examine the intent of the original Act to determine whether the special tax treatment of Internet access is still necessary or whether an alternate solution should be put in place.

I think a more fundamental point is that the states' attempt to exercise common sense in most instances when it comes to taxing business and commerce. Taxation of Internet access is a state issue, which Texas—and every other state asks that it be allowed to address as a state. I do not believe that there was ever a threat of highly discriminatory taxes on the Internet by the states. Rather, many states have sought to provide a tax-advantaged home for Internet companies as an economic development strategy. I do not believe, for example, that the Texas Legislature would be inclined to pass special taxes in this area, even if strictures were lifted tomorrow. Members of our legislatures understand and value the unique qualities of the Internet as a means of commerce, but they also understand that it should not be treated differently than other businesses operating in their states, many of whom pay state and local taxes and are in every respect good citizens of their communities.

While the MTC and FTA maintain a neutral position on congressional action on the original *Internet Tax Freedom Act* and its successor, the *Internet Tax Nondiscrimination Act,* both organizations have provided Congress several recommendations with regard to specific provisions of the Act should Congress to choose to extend the law. I would like to discuss those recommendations with you and also provide you with a bit of background on a unique solution that the state of Texas has implemented.

First, let me highlight the recommendations from the MTC and FTA.

1. We recognize that many in Congress have differing views on whether the current moratorium should be extended permanently or for a short period of time. On this point, we recommend that if Congress chooses to extend the Act that it should do so for no more than two years. Further, if the Act is extended Congress should undertake a thorough review of its impact on state and local revenues and the presence of unintended consequences due to changes in technology. The changing nature of Internet technology and its use in business operations means that the economic and fiscal impact of this Act will change over time. For this reason, a temporary—rather than permanent—extension may be appropriate.
2. The MTC and FTA believe that any extension of the current law should preserve the grandfathered ability of the limited number of states that currently impose a tax on charges for Internet access. Currently, nine states impose taxes that are protected. Repealing the grandfather clause would disrupt the revenue stream of these states at a time when nearly every state is struggling to balance its budget. Our Legislature recently completed work on a balanced budget that involved literally billions of dollars in spending reductions and no increase in taxes. We are struggling at the most fundamental level to make our revenues and spending match. If these states wish to continue to impose these taxes, they should be permitted to do so.
3. The definition of "Internet access" contained in the Act should be rewritten to insure equity among various types of access providers and among types of communications services. It should also eliminate opportunities to bundle otherwise taxable content into a single package of Internet access in a manner that would prevent states and localities from imposing their taxes on the otherwise taxable content. This last point is particularly important in insuring that an amended definition avoids an unintended erosion of state tax bases.

4. Any extension of the Act should not be accompanied by provisions or separate legislation that grants more favorable state and local tax treatment to commerce conducted electronically over commerce conducted by other means.
5. The definition of discriminatory taxes contained in the legislation should be amended to insure that it does not allow a seller through affiliates to avoid a tax collection obligation in a state even though the seller has a substantial nexus in the state. These provisions in the original Act were intended to insure that merely accessing products of an out-of-state seller via an in-state service provider would not be considered to create nexus for the out of-state seller. When the law was written these provisions were not considered problematic. However, as the electronic commerce industry has evolved, the potential for this issue to arise has grown and should be examined carefully.

The MTC and FTA believe these changes and considerations must be addressed to maintain an adequately functioning law on the taxation of Internet access—and both organizations are available to assist Congress in analyzing this issue as the debate goes forward.

Now, I would like to turn your attention briefly to how the Texas Legislature addressed the issue of taxation of Internet access—and why this is a unique solution that deserves consideration by Congress for possible nationwide implementation. By 1997, Internet access was already being utilized by some Texas businesses and was, at that time, classified as taxable "information services" by the Comptroller.

In the course of heated debate over proper state and Federal taxation of the Internet that surrounded the 1998 *Internet Tax Freedom* Act, Texas' tax policy drew some criticism. In response, the Comptroller at that time convened a broad based working group of industry leaders, traditional businesses which extensively use Internet services, and legal and accounting professionals both inside and outside the Comptroller's office, to suggest and formulate potential techniques to address Texas' taxation of Internet transactions. Our working group concluded that Internet access was taxable under the statute, and made various recommendations. One of the recommendations was to repeal the tax on Internet access, but if that was not feasible, the working group recommended that we seek clarification and simplification from the Texas Legislature.

This clarification did occur at our next legislative session in 1999 when our Legislature upon further review and in recognition of its expanded use by both individuals and businesses, determined that charges for Internet access were separated from the category of "information services" and classified them separately as "Internet access" in the Texas Tax Code. By this time, numerous Internet Service Providers had established customer accounts in Texas to provide Internet access to Texas residents and businesses. However, the Legislature and Comptroller were mindful of the benefits of this new technology and the desire to insure that every Texas resident was able to obtain tax-free basic access to the Internet. To achieve this goal, in 1999, the Texas Legislature passed Senate Bill441 (Tex. Tax Code Sec. 151.325) that exempts from taxation the first $25 of Internet access charges.

Our state law—and our tax rate on Internet access—has not changed since its enactment. We still provide the first $25 of Internet access charges tax-free to Texas residents—and hundreds of thousands of Texas residents have taken advantage of this tax-free option for basic Internet access.

In 2000, at Comptroller Carole Keeton Strayhorn's request, the Electronic Commerce and Technology Advisory Group (E–TAG) was formed to review policies concerning E-commerce issues facing Texas and make recommendations that would support expansion of Internet access to people and areas currently without adequate access while ensuring that Texas remained competitive in the marketplace in comparison with other states. Comptroller Strayhorn took the group's advice and came out with several recommendations. One was to seek an increase in the Internet access exemption from $25 to $50. However, due to budget constraints, the Texas legislature was unable to increase the exemption at the present time.

My purpose in providing a brief background as to how Texas obtained its solution to provide clarification and simplification in 1999 and our continued effort to improve our policies related to Internet access and other related transaction is to demonstrate that our solution was not a one-sided decision. It was a solution that was created by the Comptroller's office working closely with representatives of a cross-section of industries and other professionals. The Texas Legislature's inability this year to increase the exemption from $25 to $50 does not in any way undermine the widespread support from both taxpayers and businesses to the solution that we have implemented—and have found the growth rate for access to the Internet in the state of Texas to be on par with that achieved in other parts of the country.

The "Texas solution" is unique, but we believe it is one that Congress should seriously consider as it analyzes the need for extending the current law and tries to deal with competing requests for changes in the definition of Internet access. It provides a simple-but fair-method of insuring that citizens have tax-free access to basic Internet services while immediately resolving many questions that Congress continues to wrestle with regarding purported differential treatment of Internet service providers and bundled content.

I hope the information I have provided is helpful to the Committee and the Senate as it continues its debate on this issue. I would be happy to answer any questions you may have.

The CHAIRMAN. Thank you, sir. Mr. Beshears.

STATEMENT OF MARK BESHEARS, ASSISTANT VICE PRESIDENT, STATE AND LOCAL TAX, SPRINT

Mr. BESHEARS. Thank you, Mr. Chairman, Members of the Committee, for the opportunity to provide testimony on the extension of the current moratorium on Internet taxes. I am Mark Beshears, Assistant Vice President of State and Local Tax, Sprint. I have responsibilities for property tax, sales tax, income tax in all 50 states for our long distance division, our wireless division, and in 18 states for our local division. Sprint is a global telecommunications company. Our world headquarters is located in Overland Park, Kansas. As I said, Sprint is a provider of local long distance, wireless telecommunications, and Internet access services.

In addition to representing the views of Sprint, I'm here on behalf of the United States Communications Association, the United States Telephone Association, the Cellular Telecommunications and Internet Association, and 14 telecommunications companies, and if you've been following state telecom policy, to get 14 telecommunications companies in the same room is no small feat.

We strongly support the goals of the Internet Tax Nondiscrimination Act. We commend the Committee, Senator Wyden, Senator Allen on their leadership on creating and maintaining this national policy of encouraging businesses and individuals to connect to the Internet by preempting State and local taxation of Internet access.

Our primary concern is that the current law does not accommodate the technological changes that have occurred since the act was enacted back in 1998. Internet access was a lot different. It was essentially a dial-up, 56K type of technology. Now we have high-speed Internet, broadband Internet, DSL service, 3G wire service, cable modem and direct satellite service. These services either did not exist, or were in their infancy and not available to consumers when the act was first passed in 1998.

The language of the 1998 Act is causing serious problems today. Congress wanted to ensure that the moratorium language cannot be used to preempt existing taxes on traditional telephone service, or what we call POTS, plain old telephone service. Language was added to the act to exclude telecommunications service from the definition of Internet access, and this is what's causing the problem. 5 years later, telecommunications companies are the major providers of high-speed Internet access through DSL and wireless web technologies, yet because of the telecommunications service exclusion, some states have asserted that our service is subject to taxation, while competing cable modem and direct satellite Internet access are tax-exempt.

As an aside, when I first came to Sprint 11 years ago, I was faced with a similar situation having to do with our data transmission service, what we called our X.25 protocol conversion service, which essentially was the precursor to the Internet, and when I came to Sprint, the states were starting to look at this revenue source in this service, and the FCC had opined in several cases—Computer I, II, and III, this particular service was an enhanced service, it was not a telecommunications service. But the States—that was not going to deter them.

I have been litigating that issue now for 11 years, expending millions of dollars in legal fees and resources on what is an enhanced service, what is a data transmission service. I had even one state whose law was antiquated, but that did not stop them, they tried to tax data transmission service as telegraphy, because that's what they taxed in their particular State, so what we're trying to do is get ahead of the curve. This is a unique opportunity for Congress to step in and set the rules so we don't have to expend resources on litigation and adversarial relationships.

Our proposal has two parts. First, it will eliminate the disparity in tax treatment between different Internet access providers, and second, it would address the issue of bundling. Cable modem and direct satellite providers compete directly with DSL and 3G wireless providers. Because of certain rulings by the states and the FCC, these providers sell Internet access free in most cases. However, some states have asserted the DSL includes both an Internet access and a taxable telecommunications service and, as a result, customers that choose DSL service may be charged tax when competing services are not taxed. The same service, the same end result, two different tax treatments.

This disparity we believe clearly violates the intent of the act. Our proposal makes the act technology-neutral by clarifying that telecommunications exclusion does not apply to a telecommunications service used to provide Internet access to end users, nor does it apply to a telecommunications service purchased by an Internet access provider when that telecommunications service is used to provide Internet access, again to end users, basically a sale for resale type environment. Our proposal would not have any effect on cable modem, direct satellite, or other technologies that are currently exempt. With our proposed change, all Internet access providers would be treated the same.

The second part of our proposal deals with the issue of bundling. Most states require that if you are bundling a taxable and a nontaxable service together and you do not separately state the taxable from nontaxable charges on a customer bill, then you have to tax the entire bundle, or the other option is to break out the cost of the taxable service and the nontaxable services on the customer's bill.

Our bundling provision would allow companies that sell Internet access and other taxable services as a part of a bundle to collect tax only on the taxable portion that they can reasonably identify on their books and records from the nontaxable components. Our proposal does not affect Federal, State, or local taxes and fees on any telecommunications services that are not used to provide Internet access to users, including Federal USF charges imposed by the

FCC. Telecommunications services that are not related to Internet access remain excluded from the definition of Internet access.

In conclusion, as Congress seeks to make the Act permanent, we believe that it is imperative that it be clarified so that all providers of Internet access receive the same tax treatment. A consumer should choose his or her Internet service based upon the price, equality of service, customer service, et cetera, not based upon State and local tax considerations.

Thank you, Mr. Chairman. It has been an honor and a privilege to be here before you. I'll be happy to answer any questions that you might have.

[The prepared statement of Mr. Beshears follows:]

PREPARED STATEMENT OF MARK BESHEARS, ASSISTANT VICE PRESIDENT, STATE AND LOCAL TAX, SPRINT

Thank you Mr. Chairman, and members of the Committee, for the opportunity to provide testimony for the record to the Senate Commerce Committee's hearing on the proposed extension of the current moratorium under Federal law on Internet taxes and on the discriminatory and multiple taxation of e-commerce transactions.

I am Mark Beshears, Assistant Vice President of State and Local Tax for Sprint Corporation. Prior to joining Sprint in 1992, I served as Secretary of Revenue for the state of Kansas. Sprint is a global telecommunications company with over 72,000 employees and annual revenues of approximately 27 billion dollars. As one of the Nation's premier telecommunications companies, Sprint is a provider of local, long distance, wireless telecommunications, and Internet access services.

In addition to representing the views of Sprint, I am here on behalf of the United States Communications Association (USCA), United States Telephone Association (USTA), Cellular Telecommunications & Internet Association (CTIA) and 14 telecommunications companies that contributed to and support my testimony. A list of these supporters is attached as an Appendix to this testimony.

We strongly support the goals of the Internet Tax Non-Discrimination Act, and we commend this committee's leadership in creating and maintaining the national policy goal of encouraging businesses and individuals to connect to the Internet by pre-empting state and local taxation of Internet access.

Now that this committee and the Congress are considering a permanent extension of the moratorium, it is imperative that the intent of the Act be clarified. We believe that the moratorium cannot be made permanent unless the concerns outlined in this testimony are addressed.

Our primary concern is the current law does not accommodate the technological changes that have occurred since the Internet Tax Freedom Act was enacted back in 1998. Internet access was much different than it is today. High-speed Internet access—DSL, "3G" wireless, cable modem, and direct satellite—either did not exist or were in their infancy and not broadly available to consumers.

The language in the 1998 Act is causing problems today. Congress wanted to ensure the moratorium language could not be used to pre-empt existing taxes on traditional telephone services. Language was added to the Act to exclude telecommunications service from the definition of Internet access.

Five years later, telecommunications companies are major providers of high-speed Internet access through DSL and wireless web technologies. Yet because of the telecommunications service exclusion, some states have asserted that our service is subject to taxation while competing cable modem and direct satellite Internet access are tax exempt.

Our proposal has two parts. First, it would eliminate the disparity in tax treatment between different Internet access providers. Second, it would create a uniform way to address the tax treatment of Internet access that is sold in a "bundle" with other taxable services.

Cable modem and direct satellite providers compete directly with DSL and "3G" wireless providers as means of accessing the Internet. Because of certain rulings by states and the FCC, these providers sell Internet access tax-free. However, some states have asserted DSL includes both Internet access and taxable telecommunications service. As a result, customers that choose DSL service may be charged tax when competing services are not taxed.

These state rulings are particularly damaging to telecommunications companies that sell Internet access because of the very high rates of taxation that are applied

to telecommunications services by state and local governments. A study by the Council on State Taxation found that the average state and local effective tax rate on telecommunications to be 13.9 percent, compared to 6 percent for other goods and services subject to state and local sales taxes. Tax rates like these have a measurable impact on customer purchasing decisions.

This disparity clearly violates the intent of the Internet Tax Non-Discrimination Act. Our proposal makes the act technology-neutral by clarifying the "telecommunications exclusion" does not apply to telecommunications service used to provide Internet access to users, nor does it apply to telecommunications service purchased by an Internet access provider when that telecommunications service is used to provide Internet access to users.

Our proposal would have no effect on cable modem, direct satellite, or other technologies that are currently exempt. With our proposed change, all Internet access providers would be treated the same.

The second part of our proposal would ensure that Internet access is not automatically taxable when sold with other telecommunications services. Currently, most states require that when taxable and non-taxable goods are sold together, or "bundled", the entire "bundle" is taxable unless the seller separately states the exempt item on the customer's bill. Some states also apply this same logic to services.

The "bundling" provision would allow companies that sell Internet access and other taxable services as part of a "bundle" to collect tax only on the taxable portion if they can reasonably identify the non-taxable Internet access in its books and records kept in the regular course of business.

Our proposal does not affect federal, state, or local taxes and fees on any telecommunications services that are not used to provide Internet access to users or that are purchased and directly used to provide Internet access to users, including Federal USF charges imposed by the FCC. Telecommunications services that are not related to Internet access remain excluded from the definition of Internet access.

The following are "real world" examples of the issues addressed in this testimony:

- *Retail sales of Internet access*

  Currently, the retail sale of Internet access is often subject to varying treatment from state to state. For example, states are all over the map regarding whether a charge for DSL service represents a charge for telecommunications or a charge for Internet access. Alabama and Kentucky have opined that charges for Internet access via DSL are taxable as telecommunications service. On the other hand, Louisiana and South Carolina have opined that similar charges are exempt Internet access.

  States have also given different opinions on the taxability of Dedicated Internet access services. Florida and Illinois have opined that charges for Sprint's Dedicated Internet access are subject to tax as charges for communications service. The scope of these opinions included not only charges for the dedicated access line, similar to a DSL line, supporting the access; but also separately stated charges for each user's Internet Protocol (IP) Ports. These IP Port charges are Sprint's retail charges to each customer for their ability to access the Internet. The purpose of the service is the provision of high-speed, "always on" Internet access, yet these states have opined that such charges represent charges for both telecommunications service and Internet access. Consequently, Sprint is collecting tax on sales of Dedicated Internet Access Service to users in these states. On the other hand, Texas and Massachusetts have opined that the very same charges represent charges for Internet access. These examples of the varying tax treatment of residential DSL and Dedicated Internet access services have resulted from the outdated language of the current Act.

- *The Wholesale sale of Internet access*

  The language of the current moratorium is also unclear as it relates to the sale of IP backbone, or bulk Internet access from IP backbone providers to other Internet Service Providers (often referred to as the "Wholesale" sale of Internet access). The language of the current Act does not specifically address this transaction, consequently, the scope of the moratorium has been interpreted differently by both states and carriers alike. Florida, Illinois, and Missouri have opined that Internet Service Providers (ISPs) that make charges for Internet access cannot purchase underlying communications services for resale. Thus, sales of IP backbone, or "bulk" Internet access, from Sprint to an ISP is subject to tax as charges for telecommunications service. This is in spite of the fact that the ISP is purchasing dedicated access to the Internet backbone for subsequent sale to an end user. Other states, including Texas, have opined that while a por-

tion of this transaction is a sale of telecommunications service, at least some portion of the sale is to be treated as access to the Internet.

- *Taxation of Wireless Internet access*

  The provision of Internet access via wireless services is an emerging and rapidly growing area of concern. Third generation wireless ("3G") Internet access and wireless networking ("Wi-Fi") services are experiencing significant growth in both users and revenue. Because these services are new, there is little, if any, guidance regarding how such services should be taxed. These services are essentially Internet access service, the only difference being that they are provided via a wireless, rather than wireline, medium. As these wireless Internet access services are deployed, such services will be subject to the same inconsistent and confusing treatment unless Congress clarifies the Act. These services are at a critical phase of development, and the same protection that led to the passage of the original ITFA should be extended to these services to foster their development.

- *Bundling*

  A recent and growing trend in the telecommunications industry is to offer a package of services for a single price. For example, a company may offer wireless service, local exchange access and high-speed Internet access for a single monthly price. Under the moratorium, no tax may be imposed upon charges for Internet access. However, general sales tax theory and most state laws with respect to sale of property dictate that when taxable and non-taxable goods are offered for a single "bundled" price, the entire charge is subject to tax. The clash of these concepts seems to have been misunderstood by some states, who subject the whole "bundle" to tax despite the Federal pre-emption of tax on Internet access. This has created substantial confusion within the industry. Nineteen states have adopted statutes similar to our proposal (tax only the taxable services). One additional state has adopted the provision by rule. These states allow Internet Access to remain tax-free as long as the provider can reasonably identify the tax-exempt portion in their books and records. Recently, the state of Florida has proposed a regulation that encompasses a similar principle. Alabama and Kentucky have taken the opposite position and ruled that the entire charge was taxable unless the bill itself separated the charge for Internet access from the charge for communications services. As one can discern from these examples, this issue must be addressed and clarified at the Federal level in order to ensure that Internet Access remains tax-free even when it is sold as part of a bundle of services.

As Congress seeks to make the Internet Tax Non-Discrimination Act permanent, it is imperative that the Act be clarified so that all providers of Internet access face the same tax treatment. Our proposed changes would make the Act provider-neutral and technology neutral, so that price, quality of service, and customer service—not state and local tax considerations—would determine which provider or type of technology that customers choose for their Internet access.

Thank you again for the opportunity to present testimony.

APPENDIX A

List of Supporting Companies and Associations

ALLTEL
AT&T
AT&T Wireless
BellSouth
Cellular Telecommunications and Internet Association (CTIA)
Cincinnati Bell
Cingular Wireless
Level 3 Communications
Nextel
Qwest
SBC
Sprint
T-Mobile USA
United States Communications Association (USCA)
United States Telecommunications Association (USTA)
Verizon
Verizon Wireless

The CHAIRMAN. Thank you very much, Mr. Beshears.

Mr. Hamilton has stated that he doesn't believe that there's a threat of highly discriminatory State taxes on the Internet if the Internet tax moratorium lapses. Do you agree with that, Mr. Ripp?

Mr. RIPP. Mr. Chairman, the states, as was discussed today, are under tremendous pressure to look for sources of revenue, and if you think of Internet taxation, many states will come up with various theories about how one should be taxed, or what the issues of taxation are.

It was mentioned before that there were over 50,000 jurisdictions that could potentially tax an Internet provider. I do believe that there would be discrimination on Internet access services. I do believe that the cost of compliance for the Internet access providers would be truly burdensome, and most importantly, as the states try to see how do they tax, most states use point of presence, or where a service is used as the basis for their taxation.

The problem that we have as an Internet service provider, we often do not know the address of the people that are using our service, nor do we know the location that they're dialing in from, so the complexities that would be created by allowing states to tax Internet services would be enormous for our organization, and so I do believe that we would wind up with varying discriminatory taxes against our service, yes.

The CHAIRMAN. Mr. Misener.

Mr. MISENER. Mr. Chairman, with the caveat that of course I'm not on the front lines like Mr. Ripp's company is, I tend to agree with Mr. Hamilton that it's unlikely that there would be a slew of discriminatory taxes imposed on Internet access, or Internet access taxes, rather, and discriminatory taxes on the Internet, or on e-commerce.

However, since that is the only reason one would discontinue the moratorium, that bad outcome is one that ought to be prevented by continuing the moratorium, so just because it's unlikely, there would be no reason to discontinue the extant Federal policy as a result.

The CHAIRMAN. Mr. Beshears.

Mr. BESHEARS. Thank you, Mr. Chairman. I believe that the discrimination in the taxation is more likely to come from, as Senator Allen said, the Commissars who are going to be interpreting these tax laws.

My experience, and I've been in this business since 1979, you have these issues that come up, new technological advances, and the State audit groups look at ways to assess on these new technologies and these new services. It's just one of those things that we have to be aware of. As I said in the data area, it was clear that a lot of states did not have the ability or the capacity under the statute to tax these services, but they went ahead and tried to gimcrack them in as a computer service, a software service, an information service.

I think just the fact that when this fledgling industry started back in the mid-nineties, seven or eight states ran in and started trying to tax this access. We have revenue rulings, letter rulings from various states that take different positions on different aspects of this service. For example, if Sprint provides a dedicated

Internet backbone to a commercial business, the only object of that pipe is for that commercial business to access the Internet. Some states said that that is on Internet access, that's a taxable communications service, so I think until we get some clarification, till we firm up the interpretation of the act, we're still going to have these different positions taken by different States, and it's going to result in different providers being treated differently, different technology being treated different, and we're going to have this discrimination.

The CHAIRMAN. Mr. Hamilton.

Mr. HAMILTON. I agree with myself, Senator.

[Laughter.]

The CHAIRMAN. I find myself doing that on occasion.

[Laughter.]

Mr. HAMILTON. Quite well. I believe that the states are responsible in their taxation, and that issues like Mr. Beshears laid out can be resolved as issues have been resolved in the streamlined sales tax project and as we did in our Electronic Commerce and Technology Advisory Group by simply sitting down with industry and the concerned parties and working through the issues and coming up with a reasonable solution that can be brought to our legislatures, and we have no concern that the industries that are involved won't be represented at the table and that they won't make their voices heard, and that those voices won't be considered.

The CHAIRMAN. Mr. Ripp, in your testimony you make a very important allegation, or statement that the recent implementation by the Europeans of value-added taxes on the Internet access and online content and services has had a detrimental impact on its customers. Can you elaborate?

Mr. RIPP. Recently, the European VAT law was applied to all Internet providers, and in fact as AOL looked at its services overseas we had to raise our prices pretty dramatically in the countries affected for Internet access to cover the VAT rates.

As you know, the VAT rates overseas can be anywhere from 15 to 17, 18 percent, and sometimes are over 20.

The CHAIRMAN. So it did have a chilling effect.

Mr. RIPP. It had a chilling effect. We had to raise prices pretty immediately, because the cost to us was pretty high.

The CHAIRMAN. That effect was a leveling off, or a reduction in numbers of subscribers, or how did you feel this impact?

Mr. RIPP. Certainly, as we looked at raising the prices in the countries that were affected by the increase in tax, we did see some leveling off, but as the Internet proliferates—right now, Europe is further behind the U.S. in deployment. The U.S. is further ahead. As we look forward, going forward the people in the U.S. that are going to come on board are certainly less affluent. They are more in rural communities, and we think that keeping the cost of the service low for those people to get on board is very important.

We saw a direct result in Europe that we've had to raise prices pretty dramatically to cover the tax. We'd be forced to do the same things in the United States, so my sense is, as we try to really deploy the Internet to the lower 2 percent of the American people who are not there yet, the Americans who have not yet signed on or logged on, increasing the cost of the service to increase taxation

is going to slow down the deployment of the Internet to those people.

The CHAIRMAN. Doesn't that concern you, Mr. Hamilton?

Mr. HAMILTON. That the value added tax in other countries——

The CHAIRMAN. No, if you raise taxes, then obviously the charges are higher, therefore less people are able to afford it. I mean, that's a fundamental of economics.

Mr. HAMILTON. Well, yes, Mr. Chairman, it is, and that is why Texas decided to exclude the first $25 to get at the basic service issue. I mean, if it was—you know, I mean, we could give it away like water.

The CHAIRMAN. The price is $25, and you discount the $25, that is zero. If you have to raise it to $50, then you discount the $25, then he's paying $25, Mr. Hamilton.

Mr. HAMILTON. Well, he's paying $25 for the access. He's not paying $25 in tax, Mr. Chairman, I don't believe.

The CHAIRMAN. Well, obviously, you and I have a different view of the fundamentals of economics. If you raise the cost to the consumer, through imposition of taxes which have to be passed on to the consumer, then there are less consumers that can afford it. That's just sort of a precept that I've operated on and I think the free market operates on, so obviously it doesn't concern you.

Does it concern you, Mr. Misener or Mr. Beshears?

Mr. BESHEARS. It does to me, Mr. Chairman. The Committee on State Taxation did a study several years ago and it showed that the State and local effective tax rate on telecommunications is almost 14 percent, compared to 6 percent for other goods and service. This industry does not need another tax put on it.

The CHAIRMAN. Mr. Misener.

Mr. MISENER. Mr. Chairman, increasing the cost of Internet access by the application of new taxes certainly would be detrimental to consumers, our customers, and so we certainly would not like it seen done. I said it is likely not to occur, at least in great amounts, if the moratorium were to expire, but only because I would hope that that very basic fact is internalized by State revenue officials, but because it may not be internalized by a few State revenue officials across the country, then there is no reason for discontinuing the moratorium, whose very purpose is to prevent those sorts of bad judgments from being made.

The CHAIRMAN. Thank you. Maybe I'm overemphasizing this, but if there is an example in Europe of an unhealthy effect on the continued proliferation of the Internet because of increases in taxes, which are passed on to the consumers, then I think it's a factor we have to consider, since it has already happened in Europe, according to Mr. Ripp's testimony. I'm not that familiar with what's happened in Europe, but I think the Committee ought to explore that as we reach our conclusions as to how to handle this issue.

And perhaps I was a little less than charitable to Mr. Hamilton. Please go ahead and respond again if you'd like. I apologize for my sarcasm.

Mr. HAMILTON. It's a difficult issue. Obviously, I don't think anyone, and certainly not the Texas legislature, wants to see an increase in taxes on business at this point in our history, with the economy struggling.

The point that we approached in Texas was that the goal here was to protect basic Internet access, and so we exempted the first $25. We didn't have to delve into the complexities of what Internet access was composed of. The first $25 was accepted.

The Comptroller later came back to the legislature and recommended increasing that so that broadband access would actually be exempted. The legislature wasn't able to do that because of fiscal constraints, but I think the inclination was there, and I believe, you know, when we see an improvement in our revenue, just like these gentlemen see an improvement in theirs, we'll be able to provide that exemption, so the direction that we're going is to provide more access. That's my only point.

The CHAIRMAN. Thank you. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman. That was very instructive.

Mr. Hamilton, I'm struck by how similar the arguments you're making are to those that we heard 6 years ago. I mean, you basically used almost exactly the same words on the first page of your statement. You talked about how the law preempts taxation. It says, continuing preemption from taxation. Tell me how our law preempts taxation when if, for example, you walk into a store and you buy something the traditional way and you pay a sales tax, that that purchase, when compared, say, with walking into a KMart and ordering the same thing online and paying the tax online, how are we preempting taxation, when our bill specifically allows that?

Mr. HAMILTON. Well, I think in that case, Senator, the testimony is referring to the taxation of Internet access, or to the complex of services that might be delivered as part of an Internet service, and I don't think the issue for the states are so much that we should be able to tax it, or we should not be able to tax it. It's simply that we should be able to decide that policy as a matter of how we finance our States.

Senator WYDEN. So you're not saying, then, that your statement is right, because I gave you a example of how we're not preempting the Internet from taxation. Do you disagree with that?

Mr. HAMILTON. Senator——

Senator WYDEN. All you need to say is yes or no. If you want to talk about another subject, we'll talk about that, but I gave you an example of how we're not preempting a state from taxation. Do you disagree?

Mr. HAMILTON. May I explain?

Senator WYDEN. Sure.

Mr. HAMILTON. I agree that you're not interfering with the taxation of transactions. The only thing that the testimony was referring to, and perhaps not as clearly as I needed to have written it, was that the states should not be preempted from the taxation of Internet access or other things that are legitimately taxed under State laws.

We had to go to the taxation of services in the 1980s because of a budget situation that we faced then. It wasn't a choice of the tax agencies. It wasn't particularly a choice of the legislature. It was simply that or go to some other more obnoxious revenue source, at least as far as we look at it in Texas, like the personal income tax.

Senator WYDEN. Does your organization favor the overturning of the Quill decision?

Mr. HAMILTON. No, sir, we don't.

Senator WYDEN. You do not?

Mr. HAMILTON. No, sir.

Senator WYDEN. You're not in favor of Congress overturning the Quill decision, which requires a nexus for taxes. Are you sure about that? I'm almost certain that every Texas official who has come here to testify against our proposal supports it. Now, I think it would be great if you were changing your mind, because I'm sure we'll have another vote on the floor of the U.S. Senate, so I want to give you a chance to be clear on that.

Mr. HAMILTON. We have had the opportunity, Senator, to join in lawsuits that would attempt to overturn Quill in the Supreme Court. What we chose to do, and the Comptroller made a very definite decision in this way and sought the direction of the legislature, was to work with the States, to work with the industry, to work with the citizens to find a way to streamline the sales tax in all of the states in an effort to convince the Congress that it was time to bring those transactions under it, so no, we don't seek to overturn the Quill decision in the courts.

Senator WYDEN. How about in the Congress? That was the question. We'll have a vote, I'm quite certain. When Senator Allen and I and others bring this to the floor we'll have a vote on the floor of the U.S. Senate about whether Quill ought to be overturned. Are you all going to support the Congress overturning Quill?

Mr. HAMILTON. I think we will support a streamlined initiative that changes the definition so that we can collect remote services when it's appropriate.

Senator WYDEN. Let me ask a third time. Are you going to support—there will be an amendment on the floor of the Senate overturning Quill. Will you support that?

Mr. HAMILTON. Senator, I don't believe it will be—I'm not familiar with how you write laws, but I don't think——

Senator WYDEN. We had a vote on it the last time this came up. It's what the issue has always been about, and you know it has always been about it because it's been about catalogue sales, it's about phone sales, now it's about the Internet. It's a simple question. Maybe after you think about it you'll give us a position.

Mr. HAMILTON. We think, Senator, those sales, if they are sold into our State, and if they are the same as a brick and mortar retailer would collect tax on, they should collect tax. If that means, in your mind, overturning Quill, or coming to new standards of taxation, we favor that, yes.

Senator WYDEN. OK. Let me, if I might, a question for you, Mr. Beshears, and you all have been very helpful and very constructive in getting into some of the technical aspects of this. The moratorium, and I'll read you from the report here, applies to online services, Internet access services, communications or transactions conducted through the Internet, regardless of the technology being used to deliver the services. We're talking about the switch network, basic phone system, cable, and wireless. Quote, however, it only applies to the portion of the medium being used to provide such services.

Companies can and do break their billing now, in landline phone service, cable service, Internet access, and wireless. My question to you is, what justification does a state have to tax Internet access when it's a separate line item? It looks to me like it would violate our law.

Mr. BESHEARS. That's a good question, Senator, and that is the perplexing issue involved in this. We have something called a dedicated IP port charge that we would charge somebody for, basically the gateway to the Internet. Some states have opined that that's not Internet access.

If you look at the 1998 Committee report——

Senator WYDEN. That's what I was reading from.

Mr. BESHEARS.—it's clear that it appears to me that the transmission piece, the transport piece, if it is being used as a dedicated Internet pipe, that it should be exempt, but the states have taken disparate positions on that issue.

Senator WYDEN. So we're clear on this point, states are violating the law right now.

Mr. BESHEARS. Yes.

Senator WYDEN. Is that correct?

Mr. BESHEARS. That's correct.

Senator WYDEN. I think that's an important point, and I think the Committee report is very clear with respect to Internet access.

Now, Mr. Hamilton wants to go out and shellac 97 million American households, and that's his position, to try to figure out how to impose new taxes, and you've just told us for the record that the law is being violated right now, because you can break down billing into these various kinds of services and states are violating the law. Now, it doesn't give us a lot of confidence in terms of how we're going to approach this again.

And certainly my colleagues have questions, and my time has expired.

Senator BURNS [presiding]. Thank you, Senator Wyden. Mr. McCain has turned the gavel over to me, and I shall ask a couple of questions, and I'm going to turn it over to Senator Allen. You guys can just have at it. I don't want you to beat up on these guys. The way these guys started off this morning, I thought we had a full moon or something.

[Laughter.]

Senator BURNS. First of all, a couple of observations. Mr. Beshears, thank you very much. Obviously, you've had quite a lot of training in communications, but I think your statement was as clear about what this debate is about as anybody we've ever had at the table, to be honest with you.

You know, there are a lot of folks—I hope that every Senator and every Member of the House of Representatives reads your statement, because I think it really identifies what this debate is about, and how we should approach it.

Then I've drawn another conclusion, with Mr. Hamilton, and I see where he's coming from, that it boils down to definitions, what we do, how do we define enhanced services, or special services that would fall under the category of value-added tax, or any of this kind of thing, so I think we've got to wrestle a little bit about definitions as we move this along.

I'm especially interested in the bundling idea, Mr. Hamilton. How does Texas handle bundled services? Can you give me an idea on how you look at that?

Mr. HAMILTON. Senator, we wrestled with that quite a bit, and we were very concerned, just because of the complexity of the technology and the range of providers that were becoming involved, we would not be able to sort out the services that were truly Internet access or that were enhanced services, and that really is why the legislature elected to simply exempt the first $25 of the access fee, assuming that, you know, let's say, as a standard America Online—it was $24.95 or something at the time—would provide basic access at that level.

The Comptroller would like to see that extended to high-speed, where that basic service is also extended, and what we tried to do was to avoid the entire issue of what bundling was and what should or should not be in the service.

Senator BURNS. What I'm getting down to is, say you've got America Online, and basically you're right, back in the mid-nineties it was basically a 56K dial-up service, and that's all we had, but then we've seen DSL come on, we've seen broadband come along, now we've seen 3G, and now Wi–Fi is starting to really take hold. We're finding it where you buy your coffee now, I don't want to give them a special plug here, but in areas where people congregate and spend some time and use the Internet as a source.

I can't get over the idea that, I was really surprised the other day at a guy sitting in a coffee shop, and he had a computer that was about this big, and he was a salesman, he sticks it in his briefcase, and he had about an hour between calls, so he goes in, has lunch or whatever, there's Wi-Fi access, and he does all of his paperwork online between calls. I mean, I find the efficiency of this—now, in that case, would you call that an enhanced service in your taxing debate, or in your taxing code in Texas?

Mr. HAMILTON. We simply don't make the distinction, Senator. The first $25 that that company pays for that Internet line would be excluded from taxation, and they can deliver whatever they want after that.

Senator BURNS. Mr. Beshears, do you want to respond to that?

Mr. BESHEARS. Yes, Mr. Chairman. The bundling issue is an interesting issue. Congress has addressed bundling once before, when you passed the Uniform Mobile Sourcing Act to source wireless telecommunications. Essentially, that bundling protocol is the same protocol that we are putting forward today.

Several years ago, Sprint was going to be offering a bundle of service, long distance, local, Internet, data, fax, for one flat price, and we realized that there were components of that bundle that were going to be nontaxable, especially the Internet fees, but there are some states that don't tax long distance, there are some states that don't tax local service but do tax long distance, so we were faced with this issue of how we're going to tax this bundle.

So we approached the States and said, can we disaggregate these charges on our books and records, you come in and do an audit and determine what we are doing, if it's correct or not on audit, and to date we have had 19 States pass legislation that allows us to disaggregate our bundle on our books and records, one State has

done it by a rule, so we have 20 States basically that have adopted essentially the mobile sourcing bundling protocol.

So it is an issue for State tax administrators. They were concerned that if we had a package of services for $150, that we were going to call $149 of it Internet access to try to game the tax system, and they were very concerned about that, but we have been able to establish a relationship with a lot of states to say, you know, come in and do your audit, look at our books and records, if we can't show you that we're taxing these items correctly or not taxing these items, then you have to assess us.

So I think the bundling issue is being addressed, and to date we have not had any audit experience because it is so new, but hopefully it will be a workable win-win situation for both the states and the private sector.

Senator BURNS. The reason this concerns me is, we've done everything policywise that we know how to do, with the exception of a couple of things, that would create an environment of a buildout in broadband, high-speed Internet access into rural areas. We're finding, in states like my own, where telemedicine will play a large role in the correspondence of smaller rural hospitals with major medical corridors, because, number one, we have an aging population in rural areas, we have also an economic situation where you cannot provide those services on an affordable basis for people who live in those areas.

I have 14 counties without a doctor, and we depend highly on Internet and communications services to provide those services to those rural areas. They're also the lower income people, and to make it affordable is very much a concern of mine, because some people will just be left behind.

Mr. Ripp, I'm trying here, but I want you to respond to the VAT thing, you know, the value-added tax. I'm afraid that it would have a chilling effect on, not people who apply for the services, but I think it will really, really stunt the growth, the buildout of advanced services, broadband, and the technology that it's going to take to cover our rural areas, particularly, basically in the wireless areas.

Mr. RIPP. Senator, I would agree with you. Whenever you have taxes that are assessed against a business, the cost of compliance of delivering those taxes back to the potential 55,000 jurisdictions, the cost of the tax itself needs to either be passed on to consumers to be recovered, or it comes out of further investment and deployment of new services for the Internet, so that will be a logical consequence. That happens every day as people look at what are the various costs of operating their businesses.

If we get into complex tax schemes for the Internet that force us all into massive regulatory compliance issues, force us to debate with States, to enter into litigation with states over the years, that is certainly going to come out of our R&D budget. That will certainly come out, and we'll have to raise prices for people to provide the service, because it's just a cost of doing business.

And as you think through the Internet, that its deployment has done, we believe, wonderful things for this country, we understand what you're talking about with distance learning and with distance communications for medical services, et cetera, we think the Inter-

net has the ability to provide tremendous opportunities for this country, especially in rural areas, and we'd like to see legislation passed to make sure that the Internet continues to be simple, continues to be tax-free, to allow us to continue to invest heavily in our product and in deploying it for all Americans.

Senator BURNS. Well, I thank you for that answer, and as this legislation moves forward, and just like I said, it kind of boils down to definitions, that we all define the term the same way, I would hope that we would like to work with all of you, Mr. Hamilton, you included, because you're a very important part of this scenario and this debate, and you presented your case very well, and we want to work with you and your group, but I think, as this has developed, with Senator Allen, and I know he will do that, it will boil down to definitions on how we apply this law, and I thank all of you for coming today.

I've got to go over to protect my turf in Water Power Appropriations, and everybody in this room knows what that's about.

[Laughter.]

Senator BURNS. Thank you for coming today. Senator Allen.

Senator ALLEN [presiding]. Thank you, Mr. Chairman. I guess I'm taking over as Chairman now. I do want to say, it's not a full moon. What just happened recently, it's what is called a buck moon.

Senator BURNS. A what?

Senator ALLEN. A buck moon. It's when the new antlers start coming out.

Senator BURNS. They're in the moss.

Senator ALLEN. And then they're in the moss, and so there's velvet on those antlers, even though it's a buck moon. I don't know if you see any logic to that bit of lunacy.

[Laughter.]

Senator ALLEN. At any rate, I welcome again all of the witnesses here. Let me just make a few points and then ask you all some questions.

On the issue of Europe, I'm Chairman of the Subcommittee on European Affairs on the Foreign Relations Committee, and we did have a hearing on this issue of the VAT tax in Europe, which as I recollect just kicked in on July 1.

Mr. RIPP. That's correct.

Senator ALLEN. And maybe we would want to have a hearing in this Committee on it as well. Just for everyone's reference, it depends which country you're in in Europe as to which tax applies, and the taxes are everything from 13 percent to 25 percent, and some countries will not tax books but they will tax e-books, and the same sort of problems we have here trying to figure out tax policies, and the E.U. is going to grow, with the aspirant countries generally in Southeastern and central Europe joining in, so there will be even more countries.

The problem for a company like AOL and larger companies, while they have a different rate, the VAT tax, if you actually have a presence in that country, in Europe in one of those countries, that's the tax that applies. On the continent of Europe the lowest tax is in Luxembourg, which is 15 percent, so AOL has, I understand, set up in Luxembourg.

I'm one who always looks for the lowest prices everywhere. Madeira Island's actually are 13 percent. I'm not sure what kind of connections there are, but it's owned by Portugal. They have a lower tax than Portugal does.

Regardless—and we ought to examine it. Where this ends up being a big problem is for smaller businesses, U.S.-based businesses that cannot make an investment and locate a facility, whether in Luxembourg, or France, or Sweden, or wherever, over in Europe, and so it makes it very difficult for them to collect taxes, I know, all the different rates that they have, whether it's super-reduced rates, reduced rates, standard rates, parking rates and the various different ways that items are taxed, very similar to the problems that we have here in this country for any e-tailer trying to determine what is the tax, and I've always used the number, 7,600 different taxing jurisdictions, and I'll always remember that in one zip code in Denver there are four different taxing jurisdictions that will try and tax the same item four different ways, which makes it very—they can't even do it by zip code.

Let's get to some basics here and get the basic understandings, ground rules as to the impact of this. Who would want to give me a figure of how many people do not have Internet access now and how many people in this country do have? Somebody—AOL, you'd be the best one. Mr. Ripp.

Mr. RIPP. The figures that we have suggest that about 62 million households are online right now.

Senator ALLEN. And what percentage is that?

Mr. RIPP. Roughly, about half the population.

Senator ALLEN. Half? Is there any disagreement on that basic fact? Mr. Hamilton.

Mr. HAMILTON. No, sir.

Senator ALLEN. Does that sound about right to you all? All right.

Now—and you've heard this on a bipartisan basis—here in Congress we've been trying to make sure that more people have access to the Internet, whether it's for e-health, e-business, e-education, e-Government, and we're trying to increase the availability of the Internet and broadband in particular for consumers, because it is good, it's good for their access to Government, health, education, commerce, information, knowledge, and all the rest, and the question is, if you allow the moratorium to expire ultimately it would make the Internet more expensive, raising the overall cost of service.

It would raise the cost of service—would you not agree, Mr. Hamilton, raise the cost of service to existing individuals, families, and enterprises, and, if you increase the cost of Internet access, whether it's broadband or basic, would it not also deny people of lower income, that other 50 percent who do not have lower Internet access, wouldn't it make it harder for them to get Internet access if it costs more?

Mr. HAMILTON. Senator, obviously, if states went in and raised taxes, then on access—our point was really, if you're going to extend it, extend it temporarily again so that we can understand the issue. It wasn't really to just get rid of it, but obviously, if the states impose those taxes it would have that impact.

I can only speak—or I prefer, or feel more comfortable speaking for Texas. In our case, it would have no effect, since we are exempting that under our law, because we recognize the importance, as you do, and in fact the Comptroller in her report recommended that special tax breaks, additional tax breaks be given to providers to extend the Internet and high speed broadband into rural areas, or areas which were not currently receiving services, so we're very cognizant of that.

Senator ALLEN. Well, with our standards of learning in Virginia, basic economics, a fourth grader does understand that if you increase the price of whatever the product is, from a pixie stick to bubblegum cards, to Internet access, you recognize that if it costs more, fewer people will be able to afford it and purchase it.

So from my perspective, and I think that of Senators Wyden, McCain, and Senator Burns, is that we cannot envision any time where we'd want to add a burden to those existing users, or with our efforts to expand, as Texans are trying to do, expand the ability of people to get on the Internet, and broadband in particular, why would you want to do anything to make it less attractive, affordable, or accessible to individuals, and so that's why, when you're talking about a permanent moratorium, there are certain basic fundamental economic principles that just aren't going to change in 2 years, 4 years, 5 years.

And the fear also is, for example, that there was a luxury tax put on telephone service about 100, a little over 100 years ago, and that was to finance the Spanish-American War, and that tax is still there. We won that war.

[Laughter.]

Senator ALLEN. It's not ongoing, but nevertheless, there is a fear that once a tax is put on, there's always some reason why some government, whether it's Federal, State, or local will keep that tax on.

Now, Mr. Hamilton, I closely looked at your testimony, and you said if there was ever a threat of highly discriminatory taxes on the Internet's—you said you don't believe there's ever a threat of highly discriminatory taxes on the Internet by the States. I'm one who looks at adjectives and adverbs. Well, do you think that there might be some that are just less than highly discriminatory taxes?

Mr. HAMILTON. Well, I think some states now, there are nine that actually have taxes on Internet access at some level. I don't think that they are more—I don't think that they're discriminatory relative to other taxes on telecommunications some of the states might have, Senator.

And the other point, you know, under your leadership in Virginia, I mean, the State went out of its way, everyone knows—and I used to live in Virginia for a while. It's a great state—that the State went out of its way to make itself attractive to technology, and there are other leaders in other states who are capable of the same sort of thing, so it's really more a matter of the ability of states to decide than it is a matter that we really need more revenue in this area.

Senator ALLEN. Well, I'm one, having been Governor, and one of the four Governors at the time who was in favor of the Internet access tax moratorium. There was myself, Governor Pataki, then

Governor Wells, and Governor Wilson. Those are the four, and since then Governor Owens of Colorado has come on, and I think all the successors have generally kept that—well, maybe they haven't, but regardless, that's when this all first came up in really 1997. Congress finally acted in 1998.

When you talk about the States, I'm one who certainly respects the rights and the prerogatives of the people of the states to make decisions when it is within the States' prerogatives. This, though—and I always look at jurisdiction. This is clearly—the Internet is not something just within a State. It is interstate commerce, it's international commerce, as we've discussed, and so when it is something that clearly a tax or regulatory burdens will affect interstate commerce, there is Federal jurisdiction to intercede when there is that interstate commerce and I think a national policy which is shared by the vast majority of the people in the states that you do want people to have access to e-Government, e-commerce, e-mail, education and so forth.

Now, this issue is one that in all the decisions are based on the Quill decision and Bella Hess. These all had to do with the issue of catalogue sales, mail order, and so in my view this is as old as our Republic as an issue, and it shouldn't be overturned.

Now, you mentioned that the states, nine states imposed access taxes. Do you know how many localities imposed access taxes, Mr. Hamilton?

Mr. HAMILTON. No, sir, I don't have that information with me, I'm sorry.

Senator ALLEN. OK, fair enough.

If the States—you said if the States want to continue to impose these taxes, they should be permitted to do so. These are the nine states that impose access taxes.

Do you know how much revenue is collected by these nine states that impose access taxes on the Internet?

Mr. HAMILTON. The estimate that we have for the grandfathered states is $117.2 million in 2002.

Senator ALLEN. $117.2 million?

Mr. HAMILTON. Yes, sir.

Senator ALLEN. So you consider that a significant sum out of all of the funds that are—well, let me just have you speak for Texas. How much does Texas, the state of Texas collect from access taxes?

Mr. HAMILTON. With a narrowly defined definition of access, about $45 million, Senator, a year.

Senator ALLEN. OK, and what's the overall—that goes to the State, as opposed to Dallas?

Mr. HAMILTON. There would be probably roughly 10 percent of that, $4 or $5 million that would go to the local governments of one kind or another.

Senator ALLEN. Is that out of the $45 million, that you share 10 percent with localities?

Mr. HAMILTON. Well, we have a 6¼ percent state tax, and then localities can impose an additional, up to 2 percent for local governments, one way or another.

Senator ALLEN. And how many local governments impose an access tax of up to 2 percent?

Mr. HAMILTON. Senator, we have a different system than perhaps Colorado or some other states do. Our law is governing for the entire State, so no one has the ability to impose an access fee separate from State law.

Senator ALLEN. The State of Texas taxes 6¼ percent, is that right, access tax?

Mr. HAMILTON. Above, after the first $25.

Senator ALLEN. After the first 25,000, all right, and then—after the first $25, and then the localities, in addition to that, can have a 2-percent access tax on the amount of Internet access over $25?

Mr. HAMILTON. Yes, sir, the same as you would pay on a pair of shoes, except you don't get a $25 break.

Senator ALLEN. On your shoes?

Mr. HAMILTON. That's right.

Senator ALLEN. All right. Now, when you get to the $25 issue, let's get another basic, see if we can stipulate some facts on this. You're here, Mr. Ripp, from AOL. I know you have a few competitors, but what's the average cost, monthly cost for basic Internet access?

Mr. RIPP. For AOL it's $23.90.

Senator ALLEN. $23.90?

Mr. RIPP. Yes.

Senator ALLEN. Do others—of course, you're probably a little—of course, your service is wonderful and all of that. What do the others—what would competitors charge, about the same amount?

Mr. RIPP. There are ranges of price plans. AOL also has a $4.95 price plan, but there are people who charge $9.95 for low access fees, we're at $23.90, and broadband can go anywhere up to $55.

Senator ALLEN. You're getting into my next question.

All right, so for basic service, generally speaking, $25 for example, you'd probably be free and clear of an access tax.

Mr. RIPP. You have some consumers who do pay above that.

Senator ALLEN. Now, Mr. Hamilton, Mr. Beshears, Mr. Misener, Mr. Ripp, I think you're all aware that we've been, for the last several years, at least since I've been in the Senate, we've been looking at every incentive in the world to try to get broadband out to people, especially in rural areas. It's absolutely essential for them to be able to attract and keep businesses in rural areas. What is the average price for broadband or high-speed?

Mr. RIPP. It ranges across the country. Some of those prices are coming down, but probably around $45 would be a reasonable price.

Senator ALLEN. All right, well, would you say, then, that Mr. Hamilton, for broadband, that even Texas law that you exempt $25 of it, that for broadband, by putting a tax of 6¼ percent plus a locality, whether it's a county or town or city, another 2 percent, would actually impede the roll-out of broadband for these companies that are spending a lot of money, assuming they are using, say, fiber optic, digging through a lot of dirt to get to sparsely populated areas, that that could impede the ability of people in those areas, whether they're cities, suburbs, or out in the country, to actually be able to afford broadband? Do you agree that that would make it less likely, if you're adding——

Mr. HAMILTON. Senator, I agree with the economics lesson that I've had today. I would make two points. The Comptroller herself studied this in 2000 and recommended to the legislature that the access fee level be raised to $50 or $55 to over broadband basic service, and we supported that in the legislature. The legislature wasn't able to do it. The Comptroller will be back with that recommendation again, so we 100 percent agree with you on that.

The other thing that we were able to recommend, again we simply couldn't afford it given the fiscal situation, was to give further tax exemptions under our corporate franchise and sales tax to companies who made the investment to extend broadband into rural areas of the State, because I mean, the testimony that we heard before that Committee was, the taxes are obviously one factor, as they always are, but the additional factor, as you said, was simply the concentration of people and the expense of moving cable into those areas, or fiber optics into those areas.

Senator ALLEN. Right. Mr. Hamilton, obviously everyone has looked at incentives, but ultimately it's the consumer who makes the decision as to whether or not for themselves or for their family or their enterprise can afford it, which gets to what I want to make as the last point, and that has to do with modernizing the definition of Internet access, with the changes that have taken place in technology, and obviously in the marketplace, and Mr. Beshears was talking about, is that more and more it will not be necessary to have Internet access,whether through a telephone line or through a cable modem. It can be done wirelessly.

And in my view it clearly was not the intent of Congress to allow states to separately tax the underlying transport of any Internet access service, regardless of the method or means of transporting the Internet, or the technology used to deliver that service, and I'm hopeful that we're going to be able to address what you were saying, Mr. Beshears, and making sure it's technology-neutral, so to speak, that the point is Internet access. It's not to favor fiber or cable or telephone lines over other methods, and I think as far as I'm concerned that's one very valuable aspect of this hearing, is as we consider this legislation for a moratorium on access taxes, discriminatory taxes, and hopefully we will make it permanent, or however long it is made it seems to me that this definition ought to be modernized, and I know Mr. Beshears agrees.

Do you have any—I'd like to hear from Mr. Ripp, Mr. Misener, and Mr. Hamilton, insofar as the modernizing or upgrading to technology, the definition.

Mr. RIPP. We agree that the definition, we should be technology neutral with respect to this law, that Internet access is what we're talking about. We believe we should not tax access, and whatever new technologies are invented, and ways to get there, we believe we should be indifferent to those technologies going forward.

Mr. MISENER. We fully agree.

Senator ALLEN. Mr. Hamilton, can you agree to that or not?

Mr. HAMILTON. Yes, sir, absolutely. Technology should be treated the same, regardless of who is delivering it, or what they're delivering.

Senator ALLEN. That's pretty good, Mr. Beshears.

Mr. BESHEARS. I rest my case.

Senator ALLEN. Make sure we get a transcript of Mr. Hamilton, we finally found agreement.

[Laughter.]

Senator ALLEN. Well, that is good, because that can be a contentious issue on how you defined Internet access and the method of it.

Mr. BESHEARS. Mr. Chairman, I would say that Texas has taken several favorable rulings on the issue of Internet access and IP port charges, so the great state of Texas is forward-looking on some of these subjects. We could debate some other subjects.

Senator ALLEN. Understood. You're being diplomatic. We're trying to finish up on at least one area of agreement. That's good. That's very good.

I'd like to know, I'd ask anyone here out of this panel if you have any closing remarks on the effect of taxation on the Internet, whether here in the United States, or concerns about it abroad. There is a concern, and this was raised a couple of years ago, that what we do here could have an impact on what, say, the European Union would say as we try to work through the World Trade Organization and others, and I don't know if any—Mr. Misener, do you have any final closing comment?

Mr. MISENER. Senator Allen, yes, thank you, two quick points. Point one is, there has been a fair amount of discussion today about whether or not states would, if the moratorium were to expire, start to impose these new access taxes, or discriminatory taxes on electronic commerce, and I would just suggest, perhaps, that that's not an important prediction whether or not they would.

We have an extant Federal policy. It's half the age of the worldwide web. It has been there. It has worked extremely well. There is no reason to discontinue that policy. It ought to be continued, whether or not there's a prediction that the states would take advantage of the expiry of the moratorium.

The second point is, there has been some discussion about whether or not particular states would favor overturning the rule in the Quill decision, and in particular whether or not Texas would. I can say with certainty that Texas would not, under the current streamlined sales and use tax agreement. The legislature has definitively voted on the subject, and elected to study the most important central provision of that agreement, and come back to the legislature at the end of 2004, I believe.

The question really is not so much whether a particular state or a company or industry would agree that it's good to overturn Quill, it's when should Quill be overturned. At this point, we're in firm agreement with Texas that the streamlined sales and use tax agreement is not ready for prime time. It may someday be ready for prime time, and therefore it may at some point be the right thing for Congress to overturn that rule. We just aren't there yet.

Senator ALLEN. All right. Let me just thank you for those comments. I hope you all recognize that what we're trying to do is keep the issue, that issue separate from access and discriminatory taxes. That whole issue is very complicated, it's convoluted, and maybe there will be a day where we overturn Quill.

It's not today, and I don't see it in the near future, and I do think there is just a basic premise that makes good sense that if you

have a physical presence in a state, you have a nexus, and you're a voter there, you have a presence in that state. You're getting fire protection, police protection, schools and all the rest. If you're not, all this is is a question of making it easier for tax collectors to collect the sales and use tax, and many of them might ought to make it easier for consumers to pay the use tax, but that's not the point here.

The whole point is access, and discriminatory taxes on the Internet, and unfortunately every time that this comes up, this is held up as hostage for that, and when you listen to Mr. Hamilton, and amount of money, $45 million is collected in Texas, that's a lot of money, but nevertheless in the whole scheme of things it's undoubtedly less than 1 percent, and even for the nine states that are collecting access taxes it's a small amount, but nevertheless you could see people saying, well, let's just increase it, and increase it, and increase it, and again it would be harmful as far as access taxes.

Mr. Ripp, you wanted to answer the question, remarks on national and international Internet tax policy.

Mr. RIPP. Just if I may, Senator, as we saw our experience in Europe, in anticipation of that tax is where we did raise some of our prices in certain countries. Clearly, when you raise your prices, the Internet is less affordable for people, and that has an effect on consumers. When you increase the cost of the business, that has an effect on consumers and, most importantly, on the development of continued investment in the Internet.

We just hope, as we continue to consider this legislation, we understand, as we had the economic lesson we talked about today, that if we do raise the taxes here, it will affect the deployment of the Internet to the rest of the other 50 percent of this United States, so I strongly support this bill. I thank you for your leadership efforts and I do think that, as we go forward, keeping the Internet free of taxes for all will continue to deploy it and get all of the benefits that we know exist from the Internet today.

Senator ALLEN. Any other comments? If not, thank you, all four gentlemen, for your testimony. We look forward to working with you in the weeks to come, and hopefully get this done by the end of August in this Committee.

Adjourned.

[Whereupon, at 11:15 a.m., the Committee adjourned.]

A P P E N D I X

PREPARED STATEMENT OF THE INTERNATIONAL MASS RETAIL ASSOCIATION

The International Mass Retail Association

The International Mass Retail Association (IMRA) is the world's leading alliance of retailers and their product and service suppliers. IMRA members represent over $1 trillion in sales annually and operate over 100,000 stores, manufacturing facilities, and distribution centers nationwide. Our member retailers and suppliers have facilities in all 50 states, as well as internationally, and employ millions of Americans.

IMRA has been intimately involved with the Streamlined Sales Tax Project, which evolved from the 1998 legislation which originally imposed a moratorium on Internet taxation.

While IMRA does not oppose extension of the Internet Tax Freedom Act (ITFA) Moratorium, we would have preferred that the critical issue of state sales/use tax collection be considered in conjunction with extending the Internet tax moratorium.

History of the Internet Tax Freedom Act

It is important to recall the legislative history of the moratorium and the circumstances under which the original Internet Tax Freedom Act (ITFA) Moratorium was enacted in 1998.

The 1998 ITFA created the Advisory Commission on Electronic Commerce (ACEC). Brick-and-mortar retailers were not represented on the Commission even thou9h the ITFA provided that the Commission should include representatives from "local retail businesses."

Much of the discussion, particularly at the final two meetings of the ACEC, concerned the use tax collection question. At the Final meeting in Dallas the Commission was very dose to reaching agreement on a broad range of issues, including a "roadmap" by which states would gain the authority to compel remote sellers to collect use taxes. Reportedly, the issue that ultimately caused these negotiations to fail was the provision that would have allowed stores to take returns and service warrantees without creating "nexus."

Ultimately, the ACEC was unable to attain the required two-thirds majority vote to make a recommendation on any substantive provision. The majority report, approved by 11 commissioners, included a proposal to have NCCUSL work on a uniform sales and use tax statute.

Streamlined Sales Tax Project

In March, 2000, the Streamlined Sales Tax Project (SSTP) comprised of representatives of over 40 states was launched. Working with the business community, the SSTP developed measures to design, test and implement a system that radically simplifies sales and use tax collection and administration by retailers and states. The simplified system reduces the number of sales tax rates, brings uniformity to definitions of items In the sales tax base, significantly reduces the paperwork burden on retailers, and incorporates new technology to modernize many administrative procedures The majority report, approved by 11 commissioners, included a proposal to have NCCUSL work on a uniform sales and use tax statute.

On November 12, 2001 representatives of 33 states and the District of Columbia voted to approve a multi-state agreement to simplify the Nation's sales tax laws by establishing one uniform system to administer and collect sales taxes on nearly $3.5 trillion in retail transactions annually.

As of July 2003, 19 states have enacted legislation to reform their sales tax administration in accordance with provisions of the Streamlined Sales and Use Tax Agreement.

With the Federal moratorium on state and local taxes on Internet access expiring in November 2003, Congress should address the issue of Whether states that have simplified will be granted the authority to require all sellers to collect the states' sales and use taxes.

The Decision Rests with Congress

The decision whether remote sellers should be required to collect sales/use taxes rests with the Congress. The U.S. Supreme Court's 1992 decision in *Quill Corporation* v. *North Dakota* held that the Commerce Clause of the Constitution prohibits states from requiring sales/use tax collection by out-of-state sellers without a physical connection (or "nexus") to the state. The Court emphasized that Congress, because it is authorized to regulate interstate commerce, has the power to require out-of-state sellers to collect the taxes. Consequently, brick-and-mortar retailers are at a competitive disadvantage because they must collect sales taxes In their stores and even on their Internet-based sales (if they have a store or other facility in the state/locality of the buyer), while their remote-selling competitors need not collect the taxes.

This disparity is unfair and leads to some retailers trying to manipulate the system in order to remain competitive. Some retailers have concluded that they need not collect sales/use taxes on remote sales made through separate subsidiaries, except in jurisdictions where the subsidiary has nexus. While this may eliminate sales tax collection requirements in states where the subsidiary has no physical presence, this strategy is not risk-free. Such structural and operational issues are, of course, business decisions that each company must make for itself.

The Status Quo Puts Traditional Retailers At A Competitive Disadvantage

At present, many Internet retailers do not collect sales/use taxes for sales made to purchasers located in states where the retailers do not have a physical presence. This puts brick-and-mortar retailers at a competitive disadvantage in the states with sales/use taxes because they must collect sales taxes, while Internet retailers located outside the state do not have to collect the tax that applies on the identical sale (the "use" tax). Clearly, retailers that do not have to collect the tax enjoy an advantage over those that must.

Many of the best-known mass retailers view the Internet as a growth opportunity for sales and are actively promoting their Internet sites. Seeking to reduce the competitive disadvantage, some of these stores have set up separate Internet subsidiaries that need not collect and remit sales/use taxes, except on purchases made by customers where the subsidiary has nexus. Even these retailers, however, take little comfort from the uncertainty of their tax liability and the possibility of expensive, protracted challenges by state tax agencies.

Other popular mass retailers have elected to keep their Internet business as part of their main company structure and therefore must collect and remit applicable sales/use taxes wherever the company has a physical location. These retailers have taken this route for many reasons: they fulfill orders out of stores; they want customers to be able to return items to their physical stores and do not want to assume the risk that this could create nexus; or they want to set up Internet kiosks in their stores, again without assuming any risk that this creates nexus.

IMRA has members that are collecting sales taxes on-line and members that are not. Even so, they all support a level playing field where all retailers would be required to collect and remit sales/use taxes. IMRA strongly believes that certainty and fairness about sales/use tax collection is rational and sound tax policy.

A Level Playing Field is Sound Tax Policy

IMRA believes a level playing field, not preferential treatment for one type of seller, is sound tax policy. The most efficient means of collecting sales/use taxes is to require all retailers to perform the collection duty. The fact that an out-of-state business does not directly benefit from the services of the state is a misleading argument because sales/use taxes fall on consumers, not retailers.

Failure to Collect Sales and Use Tax by Internet Retailers Will Continue to Erode States' Tax Base

According to the U.S. Department of Commerce, in 2001 electronic retail sales were $34 billion (or 1.1 percent of all retail sales); merchant wholesale electronic transactions were $27 billion (or 10 percent of total wholesale merchant sales); and manufacturing shipments were $725 billion (18.3 percent of all transactions). This year, first quarter online retail sales in the U.S. grew to $24 billion, a 20 percent year-over-year quarterly increase, according to Forrester Research, Inc. The University of Tennessee's Center for Business and Economic Research conducted a study of State and Local Revenue Losses from E-Commerce. The Center estimated that in 2001, e-commerce caused a total state and local government revenue loss of $13.3 billion. By 2006, the Center estimates a loss of $45.2 billion.

States are dealing with the most challenging fiscal conditions in decades. In fact, Congress acknowledged the states' dire fiscal situation when It enacted the Jobs and

Growth Tax Relief Reconciliation Act, which provided $10 billion in temporary fiscal relief payments. Clearly, this situation could be resolved, in part, If they were allowed to require the collection of sales and use taxes on Internet sales.

Conclusion

The states have responded to the Supreme Court decision in *Quill Corporation* v. *North Dakota,* Congressional intent through its enactment of the 1998 Internet Tax Freedom Act Moratorium and the majority report of the Advisory Commission on Electronic Commerce. Meanwhile, E-Commerce retail transactions continue to grow at a rapid pace, further eroding a major source of revenue from state budgets.

IMRA strongly believes that now is the time for Congress to take appropriate action that will provide a level playing field for retailers by giving states the authority to require the collection of sales and use taxes for e-commerce transactions.

THE BUSINESS ROUNTABLE
Washington, DC, July 15, 2003

Chairman,
PHILIP M. CONDIT,
The Boeing Company.

Cochairmen,
HENRY A. MCKINNELL,
Pfizer.

EDWARD B. RUST, JR.,
State Farm.

JOHN J. CASTELLANI,
President.

PATRICIA HANAHAN ENGMAN,
Executive Director.

BY FACSIMILE

Hon. JOHN MCCAIN,
Chairman,
Committee on Commerce, Science, and Transportation,
United States Senate,
Washington, DC.

Dear Mr. Chairman:

The Business Roundtable wishes to submit for the Committee's hearing record of July 16, 2003, our views on legislation to extend the current moratorium under the Internet Tax Freedom Act on Internet access taxes and on the discriminatory and multiple taxation of e-commerce.

The Business Roundtable, an association of chief executive officers of leading corporations, supports extending the current protections of the Internet Tax Freedom Act, which otherwise will expire on November 1, 2003, which is essential for encouraging the continued growth of electronic commerce.

At the same time, we are concerned that the current definition of Internet access in the law does not reflect changes in technology and in the marketplace that have occurred since the first moratorium on Internet access and on multiple or discriminatory taxes on electronic commerce was enacted in 1998. For example, some states have asserted that certain forms of high-speed Internet access, such as those provided by "DSL" and wireless technologies, are actually telecommunications subject to tax. These technologies, which were not widely used by consumers in 1998, should not be treated in a disparate way from technologies that provided Internet access at that time (such as "dial-up" Internet services) or that may not be deemed to be telecommunications (such as cable modem Internet services).

The Business Roundtable therefore urges the Committee to modernize the definition of Internet access as part of any legislation it may consider to extend the current protections in the Internet Tax Freedom Act. This is essential to ensuring that the law is applied consistently and in a technology-neutral way.

Given the importance that electronic technologies have for cost reduction, improvement of service and expansion of markets, the development of balanced rules for the taxation of e-commerce is critical both here and abroad. The Business Roundtable looks forward to working with you to achieve this goal.

Sincerely,

JOHN J. CASTELLANI.

PREPARED STATEMENT OF GROVER NORQUIST, PRESIDENT,
AMERICANS FOR TAX REFORM

Chairman McCain and other members of this committee, thank you for the opportunity to address you regarding S. 150, the Internet Tax Nondiscrimination Act.

My name is Grover Norquist and I am President, Americans For Tax Reform (ATR), a non-partisan, not for-profit non-partisan coalition of taxpayers and taxpayer groups who oppose all Federal and State tax increases. I submit my comments to you today in strong support of a permanent moratorium on taxing Internet access.

In 1998 Congress acted to put to an end taxes that unfairly single out the Internet. However, the current moratorium is scheduled to expire on November 1, 2003, unless Congress acts to eliminate taxes on Internet access, double-taxation of a product or service bought over the Internet, and discriminatory taxes that treat Internet purchases differently from other types of sales. Fortunately, S. 150 meets all of the above criteria.

In addition, Senator Allen's legislation ensures that the permanent moratorium on Internet access taxes applies to all 50 states. Unfortunately, the original moratorium enacted in 1998 and extended in 2001 contained a grandfather clause, which permitted a few jurisdictions already taxing Internet access to continue to do so. In an effort to protect consumers that use the Internet, the Internet Tax Non-Discrimination Act strikes the grandfather clause. *Federal law should no longer reward those tax authorities that rushed to be the first ones to tax Internet access.*

ATR has always been supportive of a permanent ban on Internet taxes, and supported a two-year extension only as a compromise solution. While last years' extension was a disappointment, the House of Representatives should take the opportunity to permanently extend the moratorium in order to keep access taxes off of the Internet. *Therefore, Congress should ensure that there is no state sales tax simplification added on to the current legislation.*

A sales tax on Internet purchases, at this time, would be harmful to electronic commerce and the economy as a whole. Internet taxation will limit the expansion of electronic commerce and in effect, hinder economic growth. Moreover, there is no evidence at this time that Internet sales are hurting state sales tax revenue, since Internet purchases represent only a small 2 percent of total retail sales.

Contrary to some arguments, taxing the Internet will actually hurt Main Street businesses far more than it will help them. Internet access has allowed Main Street businesses to link into a worldwide market, which has the potential to increase market share for small businesses and offer consumers more choice. *To allow states to tax Internet commerce will hurt the very people that some politicians and other interest groups are claiming to help.*

ATR advocates for the speedy consideration of the Internet Tax Non-Discrimination Act. If Congress does not pass a new ban on Internet access taxes and multiple and discriminatory taxes it will mean a de facto tax increase on Americans at a time when they least are able to pay it. Not only that, this tax will hit schools, libraries, hospitals and families—those who use the Internet for research, education, and most critically, communication. This is not the time to be adding a new tax on Americans trying to keep in touch with loved ones. *Therefore, ATR supports a clean extension of the moratorium, without sales tax simplification language.*

Enacting a permanent moratorium on taxing Internet access will have significant benefits to the United States economy and increase the standard of living for all Americans. Ultimately, Congress has an opportunity to help American workers, individual shareholders, and all individuals by reducing the cost Internet access.

On behalf of Americans for Tax Reform, I urge your committee to quickly pass this needed legislation.

Sincerely,

GROVER NORQUIST,
President.

AMERICANS FOR TAX REFORM
Washington, DC, July 15, 2003

Hon. JOHN MCCAIN
Washington, DC.

Dear Senator McCain:

In addition to my written testimony I have submitted to the Senate Commerce, Science and Transportation on S. 150, the Internet Non-Discrimination Act, I would like to state my opposition to narrowing the definition of "Internet access" to force Internet access providers to unbundle software, services and content. Because narrowing the definition exposes millions of Internet access subscribers to new taxes on portions of their monthly subscription fees, support for this new definition represents a vote for a tax increase.

Those who argue in favor of unbundling software and content services from Internet router service are advocating for a tax increase on digital online services for Americans that use them. Because Americans for Tax Reform (ATR) strongly opposes efforts to tax the Internet, we believe that there should be no attempt to narrow Internet access definitions, which, in turn, permits states and localities to expand their tax jurisdiction to online digital services.

Taxation of digital content will significantly discourage consumers from accessing content on the Internet. As a member of the Advisory Commission on Electronic Commerce, I have witnessed firsthand that the most used aspect of the Internet is the delivery of services, information, software, and other resources. Applying a myriad of state and local taxes to this transmitted data will encumber the free flow of information. Supporters of unbundling will force subscribers to fill out a tax form, provide a zip code, and pay 5 to 10 percent more for Internet service, before receiving any information.

Congress has already provided a clearly defined and constructive prohibition against taxes on Internet access. However, some pro-tax individuals and governments are advocating for Congress to narrow the definition of Internet access that will expose Internet users to new taxes on the services and content that they have been receiving tax-free. *Therefore, any attempt to narrow the current tax protection provided to American Internet users will result In new tax burdens, or tax increases, on consumers.*

Americans for Tax Reform will continue to work with members of the Senate Commerce, Science, and Transportation Committee to reduce current barriers to e-commerce. I strongly encourage you to oppose any efforts to add language requiring Internet access providers to unbundle software, services and content.

Sincerely,

GROVER G. NORQUIST,
President.

PREPARED STATEMENT OF THE MULTISTATE TAX COMMISSION

The Multistate Tax Commission is pleased to present this statement regarding the Committee's consideration extending the moratorium on state taxation of charges for Internet access.

The Multistate Tax Commission is an organization of state governments that works with taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. 44 states and the District of Columbia participate in the Commission. Formed by an interstate compact, the Commission:

- encourages tax practices that reduce administrative costs for taxpayers and states alike,
- develops and recommends uniform laws and regulations that promote proper state taxation of multistate and multinational enterprises,
- encourages business compliance with state tax laws through education, negotiation and enforcement, and
- protects state fiscal authority in Congress and the courts.

The Commission monitored provisions contained in the *Internet Tax Freedom Act* when it was enacted in 1998 for their potential impact on state taxing authority. The Commission maintains a neutral position on congressional action on the original Act and its successor, the *Internet Tax Nondiscrimination Act*. The Commission does make several recommendations with regard to specific provisions of the Act should Congress choose to extend the Act. This position is reflected most recently in the approval of Commission Resolution 01–08 approved in July 2001 (attached).

The Commission believes that five guidelines should be addressed as Congress considers extending the *Internet Tax Nondiscrimination Act* upon its expiration in October 2003. Principally, these guidelines include:

- The Act should be extended for no more than two years to insure a review of its impact on state and local revenues and the presence of unintended consequences. The changing nature of Internet technology and its use in business operations means that the economic and fiscal impact of this Act will change. A temporary extension is appropriate in this context.
- Any extension of the Act should preserve the grandfathered ability of those states currently imposing a tax on charges for Internet access to continue to do so if they so choose.
- The definition of Internet access contained in the Act should be rewritten to eliminate opportunities to bundle otherwise taxable content into a single package of Internet access in a manner that would prevent states and localities from imposing their taxes on the otherwise taxable content, thus preserving competitive equity among all forms of commerce.
- Any extension of the Act should not be accompanied by provisions or separate legislation that grants more favorable state and local tax treatment to commerce involving goods or services transferred, conducted or delivered by electronic or other remote means as compared to commerce involving goods or services transferred, conducted, or delivered by other means.
- The definition of discriminatory taxes contained in the legislation should be amended to insure that it does not allow a seller through affiliates to avoid a tax collection obligation in a state even though the seller has a substantial nexus in the state.

Extending the Act and the Potential Economic Impact. A moratorium on taxation of Internet access charges was originally imposed in 1998 as a means of providing the then burgeoning Internet industry with protection from the sudden imposition of certain specific state and local taxes. Five years ago, it was clear that the Internet industry would become a major force in the economy and that some temporary measures might be warranted to insure that the Internet industry did not suffer from a burden of over regulation or taxation. Today, the Internet is a vibrant, well-established industry that is a major component of the national economy. Thus, the moratorium was enacted as a *temporary* measure—but its continued effectiveness and necessity should be re-examined periodically.

The Commission believes that several questions regarding the potential economic impact on the Internet industry and state and local governments should be posed when considering whether to extend the existing moratorium:

- Does the current preemption of taxation of Internet access create discrimination in favor of a select group of Internet providers? Specifically, are large companies that have the ability to bundle Internet access with other services (like telecommunications, information, or entertainment) provided an advantage over smaller companies without the financial means to provide bundled services?
- To what extent have studies documented that a pre-emption of taxation of Internet access has increased the volume of subscribers to such access?
- Conversely, to what extent have studies documented that taxing Internet access has served as a deterrent to potential subscribers? Specifically, the existence of state taxes on Internet access in nine of the states covered by the grandfather provision of the legislation provides for a basis for comparing the growth of Internet access in those states vs. other states. Will Congress make this comparison before making a decision on extending the Act?
- In lieu of taxing Internet access, have states and localities imposed or increased other taxes on the Internet industry to compensate for the loss of revenue?

In addition to considering the above, legislation under consideration in the Senate also proposes repealing the grandfather clause in the existing moratorium that provides nine states with the ability to continue imposing taxes on Internet access that were in effect when the original law was enacted. The Commission believes that repealing this grandfather would represent an inappropriate pre-emption of a state's existing taxing authority. The states protected by the grandfather clause—New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington, and Wisconsin—tax Internet access under their current laws that govern the taxation of services. The revenue generated from the imposition of the tax is an important component in the revenue base of each of these states—many of which are now struggling to balance their individual state budgets. To repeal the

grandfather clause for these states would represent an erosion of their revenue base, shift increasing responsibility for the tax burden to other taxpayers, and upset the balance of the states' internal tax policy objectives.

Definition of Internet Access. Any consideration of extending the moratorium must include a re-evaluation of the definition of Internet access within the moratorium to account for the increasing variety and extent of services that are "bundled" with access.

Since Congress wrote the original definition, changes in technology and corporate business structures have made it clear that it is now possible for large enterprises to bundle a broad array of otherwise taxable services with Internet access. The current definition appears to create the potential for discrimination in tax policy that would stifle competition and increase consumer costs, provide financial advantages to large enterprises, and erode state and local tax bases. Services delivered by large enterprises that can assemble the capital, technological, information and entertainment resources to bundle an array of services with Internet access would appear to be granted a tax exemption under the current language of the moratorium. The same services delivered through the Internet by smaller enterprises without the bundling capability or by non electronic means would remain taxable. There is no economic or tax policy justification for Congress to create this disparity. Expanded bundling by large enterprises can substantially erode the tax bases of state and local governments that tax services.

The definition of Internet access should cover only access to the Internet. Because of the increasing problems in distinguishing between pure access and other services, Congress should explore a quantitative approach to defining access, such as was enacted by the State of Texas in the last few years. A quantitative approach to defining Internet access removes all ambiguity concerning what constitutes "access" as opposed to other services. Further, it creates a level playing field among all providers of Internet access.

Discriminatory Taxes. Sections 1104(2) (A) (iii) and 2(B) (ii) (II) of the1998 Internet *Tax Freedom Act* and its successor, the *Internet Tax Nondiscrimination Act,* are components of the definition a discriminatory tax. In its entirety, the definition was intended to protect on-line retailers from unfair taxation by states and localities so that e commerce would receive the same tax treatment as all other forms of remote commerce. Read together, the interplay between these two provisions could have another, unintended effect by encouraging brick and mortar retailers to engage in sophisticated tax planning strategies that will allow them to escape the responsibility to collect sales tax on sales made in those states where they otherwise have clear sales tax nexus. Across the nation, large brick and mortar retailers with nexus in various states have attempted to escape sales tax collection on in-state sales by creating a separate, out-of-state Internet-based sales subsidiary to handle customer orders and payments, despite the substantive operational ties that exist between the parent retailer and its Internet subsidiary. Such ties may include allowing customers to return items purchased from the Internet subsidiary to the parent retail store, or having the parent retail company distribute promotional items on behalf of its subsidiary. Though there are other reasons why retailers might implement this "entity isolation" tax strategy to escape sales tax responsibility, the discriminatory tax definition in the Internet Tax Freedom Act has the appearance of sanctioning this kind of tax avoidance behavior. The result in these cases is unfair to other retailers who register and collect sales and use taxes.

Summary

The Internet has developed from infancy to maturity with amazing speed and has become an invaluable segment of the Nation's economy. What was once thought to be technology that would be used by a select few has become an integral part of everyday life for nearly all Americans. Recognizing that the Internet has reached this mature stage, Congress must now decide whether it is necessary to extend protections from regulation and taxation that it initially imposed. The Multistate Tax Commission strongly urges Congress to give careful consideration to the economic impact on states from this continued protection—as well as consideration of the consequences of Federal pre-emption of state taxing authority. In addition, Congress should seriously examine if extending the current moratorium on taxation of Internet access creates potential disparities and competitive disadvantages in the marketplace among providers of Internet access. A careful review and analysis of these issues should provide Congress with the background it needs to determine if extension of the *Internet Tax Nondiscrimination Act* is warranted at this time.

ATTACHMENT

MULTISTATE TAX COMMISSION

Resolution No. 01–08

Resolution Regarding Tax Fairness in the Proposed Federal Extension of the "Internet Tax Freedom Act"

WHEREAS, the Internet Tax Freedom Act expires on October 21, 2001; and

WHEREAS, the Act imposes a moratorium on the imposition of new taxes on charges for Internet access and prohibits multiple and discriminatory taxes on electronic commerce; and

WHEREAS, Congress is considering various measures to modify and extend the Act, including an extension of the moratorium on the imposition of taxes on charges for Internet access and the elimination of the existing grandfather clause that permits states that already imposed and enforced such taxes to continue to do so; and

WHEREAS, electronic commerce business models, technology and practices have changed significantly since the enactment of the Act in 1998, especially in the areas of "access" and "content"; and

WHEREAS, certain of those changes, when coupled with an extension of the Act, could have unintended consequences and expose state and local revenue systems to substantial adverse consequences; and

WHEREAS, Congress is using the extension of the Act as a vehicle to examine the issue of sales and use tax collection by remote sellers not now required to collect tax on sales into a state;

WHEREAS, some of the proposals that have been introduced in Congress potentially treat electronic commerce more favorably than other forms of commerce; and

WHEREAS, sound tax policy demands that all forms of commerce be treated equally, and

WHEREAS, there is no economic reason to justify treating electronic commerce, or other forms of remote commerce more favorably than any other form of commerce; and

WHEREAS, extension of the Internet Tax Freedom Act would constitute a preemption of state authority that is traditionally considered unacceptable by many state officials; and

WHEREAS, the Multistate Tax Commission recognizes that, nonetheless, Congress may choose to extend the Act; now therefore, be it

RESOLVED, that if Congress chooses to extend the Act, the Multistate Tax Commission respectfully urges it to do so in accord with the following guidelines:

- The Act should be extended for not more than five years to insure a review of its impact on state and local revenues and the presence of unintended consequences.
- Any extension of the Act should preserve the grandfathered ability of those states currently imposing a tax on charges for Internet access to continue to do so if they so choose.
- The definition of Internet access contained in the Act should be rewritten to eliminate opportunities to bundle otherwise taxable content into a single package of Internet access in a manner that would prevent states and localities from imposing their taxes on the otherwise taxable content, thus preserving competitive equity among all forms of commerce.
- Any extension of the Act should not be accompanied by provisions or separate legislation that grants more favorable state and local tax treatment to commerce involving goods or services transferred, conducted or delivered by electronic or other remote means as compared to commerce involving goods or services transferred, conducted or delivered by other means.
- The definition of discriminatory taxes contained in the bill should be amended to insure that it does not allow a seller through affiliates to avoid a tax collection obligation in a state even though the seller has a substantial nexus in the state.

- Provisions consistent with the standards developed by the Streamlined Sales Tax Project should be incorporated into an extension of the Act so States would be authorized to require some remote sellers without a physical presence in the state to collect sales and use taxes on sales made into the state under a simplified sales and use tax administration system.
- The requirements for a simplified sales tax system should not require adoption of specified standards of nexus for other types of state and local taxes, but should provide that collection and remittance of sales and use taxes, in and of itself, would not be considered a factor in determining nexus for other state and local taxes.
- Congress should commit itself to achieving equity in sales and use tax collections by authorizing states, in advance, but subject to congressional veto to require collection of the tax by remote sellers that exceed a de minimis sales threshold, the authorization taking effect automatically once a critical mass of states have implemented the simplifications outlined by the Streamlined Sales Tax Project.

Adopted this 27th day of July, 2001 by the Multistate Tax Commission.

DAN R. BUCKS, Executive Director

This resolution shall expire at the Annual Business Meeting of the Multistate Tax Commission in 2006.

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